S. HRG. 99-671

RETIREMENT INCOME POLICY ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 1784

JANUARY 28, 1986

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RETIREMENT INCOME POLICY ACT

TUESDAY, JANUARY 28, 1986

U.S. SENATE,
SUBCOMMITTEE ON SAVINGS, PENSIONS,
AND INVESTMENT POLICY
OF THE COMMITTEE ON FINANCE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:43 a.m., in room SD-215, Dirksen Senate Office Building, Hon. John Heinz (chairman) presiding.

Present: Senator Heinz.

[The press release announcing the hearing follows:]

[Press Release]

RETIREMENT INCOME POLICY ACT HEARING SCHEDULED FOR JANUARY 28, 1985

The Senate Committee on Finance has scheduled a hearing January 28 on the Retirement Income Policy Act of 1985, Chairman Bob Packwood (R-Oregon) announced today.

Senator Packwood said the Committee on Finance's Subcommittee on Savings, Pensions and Investment Policy would conduct the hearing. The hearing will begin at 9:30 a.m., Tuesday, January 28, 1986, in Room SD-215 of the Dirksen Senate Office Building in Washington.

Senator John Heinz (R-Pennsylvania), Chairman of the Subcommittee on Savings, Pensions and Investment Policy will preside the hearing.

The Retirement Income Policy Act, S. 1784, was introduced by Senator Heinz October 22. The bill is cosponsored by Senator John Chafee (R-Rhode Island).

S. 1784 would amend the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954 to enhance retirement security by broadening retirement benefit delivery, strengthening the present system of voluntary employer-sponsored pensions and encouraging growth and development of the private pension system by simplifying the administration of pension plans, Senator Packwood explained.

DESCRIPTION OF S. 1784 (RETIREMENT INCOME POLICY ACT OF 1985)

Scheduled for a Hearing

before the

SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

of the

SENATE COMMITTEE ON FINANCE

ON JANUARY 28, 1986

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Subcommittee on Savings, Pensions, and Investment Policy of the Senate Finance Committee has scheduled a public hearing on January 28, 1986, on S. 1784 (introduced by Senators Heinz and Chafee). The bill would set forth a national retirement income policy and would revise the rules of the Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974 (ERISA) relating to coverage, vesting, integration, and portability under pension plans.

This pamphlet [1] is prepared by the staff of the Joint Committee on Taxation in connection with the Subcommittee's January 28 hearing. The first part of the pamphlet is a summary of the bill. The second part is a description of the provisions of the bill, including the relevant provisions of present law.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Description of S. 1784 (Retirement Income Policy Act of 1985)* (JCS-1-86), January 27, 1986.

I. SUMMARY OF THE BILL

Participation requirements

Retirement plans and nonretirement savings plans

The bill would establish two types of deferred compensation plans, retirement plans and nonretirement savings plans, which could be maintained by employers. Under the bill, an employer could provide a nonretirement savings plan for an employee only if that employee is also a participant in a retirement plan that provides a specified minimum benefit. In addition, a retirement plan would be required to meet certain retirement income requirements, which provide restrictions on the timing and form of distributions from retirement plans.

Under the bill, a deferred compensation plan would be a nonretirement savings plan if it is not a retirement plan. The provisions with respect to retirement plans and nonretirement savings plans would be added to the Code and to ERISA.

Coverage requirements

The bill would revise the coverage requirements applicable to qualified plans under the Code and would extend those requirements to all pension plans subject to ERISA.

Under the bill, an employer would be considered to meet the coverage requirements if each employee in the employer's relevant workforce whose compensation is less than the social security contribution and benefit base (i.e., the wage base) is eligible to participate in a retirement plan maintained by the employer. Special rules would apply to permit coverage to be tested separately if the relevant workforce of the employer consists of two or more allowable subdivisions.

In addition, the bill would provide a special coverage test in the case of a retirement plan of an employer that provides for mandatory employee contributions if the retirement plan is used to qualify a nonretirement savings plan of the employer.

Limitations on deductions, contributions, and benefits

The bill would restrict the deduction for qualified voluntary employee contributions to contributions made to a retirement plan.

The bill would revise the rules of the Code relating to qualified cash or deferred arrangements (401(k) plans) and would add corresponding rules to ERISA. Under the bill, a cash or deferred arrangement could be provided only by a retirement plan that meets specified requirements relating to the coverage of employees. The bill would coordinate the exclusion provided for elective deferrals under a 401(k) plan with the deduction allowed to an employee for contributions to an individual retirement arrangement by reducing the deduction limit for contributions to an individual retirement arrangement by the amount of elective deferrals under a 401(k) plan.

Under the bill, the overall limits on contributions and benefits under qualified plans would be revised and the combined plan limit would be repealed if no plan in which the employee participates is top heavy.

The bill would relate the overall limits on benefits and contributions under qualified plans to the benefit and contribution base under the Social Security Act (i.e., the wage base ($42,000 for 1986)). Under a retirement plan, the dollar limit would be (1) 200 percent of the wage base in the case of a defined benefit plan, and (2) 50 percent of the wage base in the case of a defined contribution plan. The bill would provide further reductions for contributions and benefits under nonretirement plans and 401(k) plans. In addition, the bill would limit the amount of compensation that may be taken into account under a plan for purposes of the nondiscrimination provisions relating to qualified plans and the overall limits on benefits and contributions under a qualified plan. A corresponding limit on compensation taken into account would be provided by the bill under ERISA.

Vesting standards

The bill would amend ERISA and the Code to require that, in the case of a retirement plan, a participant who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions. In the case of a nonretirement savings plan, a participant would have a nonforfeitable right to 100 percent of employer contributions without regard to the participant's years of service. A special rule would apply for multiemployer retirement plans.

Pension integration

The bill would revise the integration rules under the Code for qualified plans and would add to the labor law a prohibition against discrimination by a pension plan in favor of specified employees similar to the rules of present law for qualified plans. Under the bill, a pension plan would not be considered to violate the nondiscrimination rules of the labor law or the tax law merely because the plan is integrated.

Distributions

The bill would repeal the 10-year forward income averaging and capital gains treatment of lump-sum distributions under qualified plans. In addition, under the bill, the 10-percent additional income tax on withdrawals from an IRA by the owner prior to the attainment of age 59½, death, or disability would be increased to 20 percent.

Coverage and portability

Early distributions of benefits

Under the bill, an accrued benefit would not be treated as nonforfeitable unless, in the case of any lump-sum distribution made before a participant attains age 59½, dies, or becomes disabled, the distribution is made in a direct transfer to an IRA of the participant.

Special rules for simplified employee pensions (SEPs)

The bill would revise the qualification requirements relating to SEPs to permit employees to elect to have SEP contributions made on their behalf or to receive the contribution in cash. This salary reduction feature would only be available to employers who have 25 or fewer employees. In addition, the bill would repeal the provision permitting SEP contributions to be integrated with social security and would apply a limitation on annual SEP contributions that is tied to the contribution and benefit base under the Social Security Act.

Effective dates

The bill generally would be effective with respect to any plan for plan years ending after the later of 2 years after the date of enactment of the bill or the earlier of (1) the effective date of the first plan amendment adopted after the date of enactment or (2) December 31, 1990. The provisions relating to individual retirement arrangements would be effective for taxable years ending after December 31, 1990.

A special effective date would be provided for collectively bargained plans. In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before the date of enactment, the bill would be effective for plan years ending after the later of 2 years after the date of enactment or the earliest of (1) the date on which the last of the collective bargaining agreements relating to the plan terminated (determined without regard to any extension ratified after the date of enactment), (2) the effective date of the first plan amendment adopted after the date of enactment, or (3) December 31, 1990.

II. DESCRIPTION OF THE BILL

A. Overview of Tax-Favored Pension and Deferred Compensation Arrangements

In general

Under the Federal income tax system, individuals generally are taxed on income as it is earned. This principle has been applied to tax income that is made available (constructively received) in addition to income actually received. Under the economic benefit doctrine, if there is a transfer of property in exchange for services, the individual performing the services is required to include the value of the property in gross income when the property is not subject to a substantial risk of forfeiture. In addition, the gross income of a taxpayer generally includes noncash items that are equivalent to cash. An employer's deduction for compensation paid to an employee is postponed if the employer's income inclusion is postponed.

Historically, exceptions to the economic benefit doctrine have been adopted by Congress to encourage certain retirement savings by taxpayers. In particular, taxpayers have been encouraged by the tax law to set a part of their compensation aside under current programs that generally are designed to replace compensation upon retirement. Present law provides incentives by permitting taxpayers to postpone income tax on current compensation for retirement, and on investment earnings on those savings, under special plans of deferred compensation. Under these plans, income tax is generally postponed until the time benefits are paid, even though the benefits (if funded and nonforfeitable) would otherwise be currently taxable. Also, employers are allowed deductions (within limits) when contributions are made to these plans.

Since 1921, the Internal Revenue Code has specifically provided that certain employee trusts are exempt from Federal income tax. The 1921 Code provided an exemption for a trust forming part of a qualified profit-sharing or stock bonus plan.[2] The 1926 Code provided a similar exemption for qualified pension trusts and established deduction limits designed to set appropriate limits on the extent to which tax-favored treatment would be available under qualified plans.[3]

The standards for plan qualification have been revised and expanded since 1921 to reflect Congressional interest in the expansion of pension, profit-sharing, and stock bonus plans and concern over tax abuses. The rules relating to qualified plans were substantially revised by the Employee Retirement Income Security Act of 1974 (ERISA), which added (1) minimum coverage, vesting, benefit accrual, and funding requirements, and (2) overall limits on contributions and benefits. That Act also provided for protection of pension benefits under the labor laws and for insurance of some benefits under defined benefit pension plans by the Pension Benefit Guaranty Corporation (PBGC).

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[2] Sec. 219(f) of the Revenue Act of 1921.

[3] Sec. 219(f), sec. 23(p) of the Revenue Act of 1926.

In addition to the deferral of income tax on amounts contributed to a qualified plan, present law provides an exclusion from exployment taxes (FICA and FUTA) for the amounts deferred under and the benefits paid from a qualified plan. This employment tax exclusion does not apply to elective deferrals under a qualified cash or deferred arrangement. Present law also provides relief from the effect of graduated tax rates by providing special income averaging rules for certain lump sum distributions and special treatment for net unrealized appreciation on employer securities.

Types of tax-favored retirement arrangements

Qualified plans

Under a plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan), an employer is allowed a deduction for contributions (within limits) to a trust to provide employee benefits. Similar rules apply to plans funded with annuity contracts. A qualified plan may be a pension, profit-sharing, or stock bonus plan.

A qualified pension plan may be either a defined benefit pension plan or a money purchase pension plan. Under a defined benefit pension plan, benefit levels are specified under a plan formula and are not solely dependent on the balance of an account for the employee. For example, a defined benefit pension plan might provide a monthly benefit of $10 for each year of service completed by an employee. Benefits under a defined benefit pension plan may also be specified as a flat or step-rate percentage of the employee's average compensation or career compensation. Benefits under a defined benefit pension plan are guaranteed (within limits) by the Pension Benefit Guaranty Corporation (a Federal corporation within the Department of Labor).

Under a money purchase pension plan, the amount of employer contributions allocated to the account of an employee must be fixed or determinable. A money purchase pension plan is a type of defined contribution plan; therefore, the amount an employee is entitled to receive is based solely on the balance in the employee's account. Benefits may be paid under a defined benefit pension plan or a money purchase pension plan only in the event of death, disability, separation from service, or attainment of normal retirement age.

Profit-sharing and stock bonus plans are also types of defined contribution plans. Under a profit-sharing plan, employer contributions are provided out of current or accumulated profits of the employer. Under a stock bonus plan, contributions may be made under a fixed formula or they may be related to profits of the employer. The rules for stock bonus plans generally require that benefits be distributed in the form of employer stock. Under a profit-sharing or stock bonus plan, benefits can be distributed to an employee who has not separated from service.

An employer's deductions and an employee's benefits under a qualified plan may be limited by reference to the employee's compensation. The Code also imposes overall limits on benefits or contributions that may be provided under qualified plans. In addition, subject to limits similar to the rules for individual retirement accounts (IRAs), certain employee contributions may be deductible when made. Investment earnings on the assets of a qualified plan are generally exempt from income tax until distributed.

Under a qualified plan, employees do not include benefits in gross income until the benefits are distributed even though the plan is funded and the benefits are nonforfeitable. Tax deferral is provided under qualified plans from the time contributions are made until the time benefits are received. The employer is entitled to a current deduction (within limits) for contributions to a qualified plan even though an employee's income inclusion is deferred.

Benefits or contributions under a qualified plan are subject to standards designed to prohibit discrimination in favor of employees who are officers, shareholders, or highly compensated. In addition, qualified plans are required to meet minimum standards relating to coverage (what employees participate in the plan), vesting (the time at which an employee's benefit becomes nonforfeitable), and benefit accrual (the rate at which an employee earns a benefit). Also, minimum funding standards apply to the rate at which employer contributions are required to be made to ensure the solvency of pension plans.

Coverage under employer pension plans in the United States increased from approximately 15 percent of the nonagricultural workforce in 1940 to 41 percent in 1960. Since 1960, it has increased at a much slower rate so that, by 1983, 48.5 percent of the nonagricultural workforce (or 44.3 million workers) was covered by a plan. Table 1, below, shows the distribution of coverage under pension plans by compensation levels for 1983.

Table 1.—Distribution of Total Nonagricultural Wage and Salary Workers With Employer Pension Plans, 1983

Wage and salary class	Total wage and salary workers (thousands)	Workers with employer-provided pension plan	
		Number (thousands)	Percent of workers
Less than $5,000	17,766	1,568	8.8
$5,000-$10,000	16,961	4,908	28.9
$10,000-$20,000	29,926	17,405	58.2
$20,000-$30,000	16,103	12,216	75.9
$30,000-$50,000	8,544	6,672	78.1
Over $50,000	2,088	1,529	73.2
Total	91,388	44,298	48.5

Source: Office of Tax Analysis, U.S. Treasury and 1984 Current Population Survey (reported data at 1983 levels).

Little or no data are available concerning the extent to which individuals who are participating in employer-provided plans actually receive benefits from the plans. Some participants will terminate employment with their employers before vesting in any accrued benefits. Other participants will remain with an employer long enough to obtain vested rights, but their benefits will be partially or fully offset by social security benefits (through social security integration) considered to be provided by their employers.

Tax-sheltered annuities

Tax-sheltered annuity programs may be established by public educational institutions and certain tax-exempt organizations (including churches and other organizations described in Code sec. 501(c)(3)) to provide retirement benefits to employees. Approximately 3 million persons are presently covered by these annuities.

Amounts paid by such an employer to purchase a tax-sheltered annuity (which may consist of shares of a regulated investment company (a mutual fund or a closed-end investment company)) are excluded (within limits) from the gross income of an employee even though the employee has a nonforfeitable right to benefits. Tax is also deferred on the investment earnings under a tax-sheltered annuity program. Over $3 billion in contributions were made to tax-sheltered annuities in 1983.

Tax-sheltered annuities may provide for nonexcludable employee contributions. Also, subject to rules similar to those provided for IRAs, certain employee contributions may be deducted by an employee. The limits on exclusions under tax-sheltered annuity programs may be higher than those for qualified plans.

Unlike qualified plans, tax-sheltered annuity programs are not subject to standards that prohibit discrimination in favor of employees who are officers, shareholders, or highly compensated.

Individual retirement arrangements (IRAs)

An individual is allowed a deduction for contributions (within limits) to provide retirement benefits under an individual retirement account or an individual retirement annuity (an IRA). Deductions are limited by reference to the individual's compensation. An individual is generally not taxed on amounts held by an IRA, including investment earnings, until benefits are distributed. Tax deferral is provided during the period between the contribution of compensation and the receipt of benefits. Amounts held by an IRA are subject to restrictions designed to restrain nonretirement use of the funds.

For tax year 1983, contributions to IRAs exceeded $32 billion. This total includes deductible contributions and tax-free rollovers.

B. Statement of National Retirement Income Policy Goals

Present Law

Although policy goals have been stated in the legislative history of the provisions of present law with respect to retirement income programs, that policy has not been provided by statutory provisions.

Explanation of Provision

In general

The bill states findings of the Congress with respect to retirement income policy and would declare national retirement income policy goals.

Findings

According to the bill, the Congress finds that:

(1) The growth in the size, scope, and number of employee pension benefit plans has been substantial over the past quarter of a century;

(2) Since the enactment of the Employee Retirement Income Security Act of 1974, the number of workers and their families receiving benefits under these plans has steadily increased;

(3) For most workers and their families, the benefits paid by employee pension benefit plans are a necessary supplement to benefits received through the old-age, survivors, and disability insurance program under title II of the Social Security Act;

(4) Although the number of participants covered under these plans has increased, nearly half of current workers are not covered under any plan, and that percentage has remained relatively constant for the past decade;

(5) Even among workers covered by employee pension benefit plans, only 50 percent of those covered are currently entitled to receive benefits from those plans;

(6) The current rules regarding coverage, vesting, and integration of employee pension benefit plans with benefits under the old-age, survivors, and disability insurance program under title II of the Social Security Act tend to impede the policy goals of broadening of coverage and improving benefit delivery, particularly for mobile workers;

(7) Current incentives for plan formation have been inadequate and special incentives are needed to encourage small businesses to establish employee pension benefit plans;

(8) The lack of consistency and coordination of the rules governing various types of employee pension benefit plans has led to an erosion of the fundamental concept that retirement plans should provide retirement benefits;

(9) The frequency with which legislative changes affecting employee pension benefit plans have been enacted over the past decade have led to both uncertainty as to what the law requires and substantial additional administrative expenses for such plans which, in turn, has discouraged the growth and development of employee pension benefit plans; and

(10) The lack of an articulated national retirement income policy has encouraged frequent and piecemeal changes.

Declaration of policy

The bill declares that its policy is to articulate certain basic national retirement income policy goals and to make certain changes to ERISA and the Code in pursuance of those goals.

The bill provides that it is the sense of the Congress that the following national retirement income policy goals should be pursued:

(1) The old-age, survivors, and disability insurance program under title II of the Social Security Act should be the universal and fundamental source of retirement income security for each American.

(2) Retirement benefits provided by title II of the Social Security Act should be supplemented with benefits provided from employer-financed retirement plans.

(3) Retirement benefits provided by title II of the Social Security Act and employer-financed pensions should be supplemented by individual savings for retirement.

(4) The current voluntary system of employer-sponsored retirement plans should be retained; and the growth and development of such plans should be encouraged.

(5) Although the age of retirement should be an individual decision, workers should be encouraged by public policy to remain in the work force throughout their productive years.

(6) Employer-sponsored retirement plans should be sufficiently flexible to deliver adequate retirement benefits to workers with a variety of career patterns.

(7) Benefits which are accumulated for retirement should be retained for that purpose.

(8) Although elective approaches to retirement savings may be useful in supplementing employer-financed retirement benefits, public policy should be developed with the recognition that employer-financed retirement programs can be more effective in delivering benefits to a broad cross-section of the population.

(9) Employer-sponsored savings for purposes other than retirement should be encouraged for employees participating in a meaningful retirement program.

(10) To the extent possible, retirement income should be provided from a variety of sources and should be sufficient to maintain an employee's preretirement standard of living throughout retirement.

C. Participation Requirements

1. Retirement plans and nonretirement savings plans (sec. 101, 102, 104, 201, 202, and 204 of the bill, secs. 3, 211, and 213 of ERISA, and secs. 401, 409A, and 414 of the Code)[4]

Present Law

Distribution restrictions

Under a qualified pension plan, benefits may be withdrawn on account of plan termination or an employee's separation from service, disability, death, or attainment of normal retirement age. Withdrawals from qualified profit-sharing or stock bonus plans are subject to fewer restrictions than withdrawals under qualified pension plans. Qualified profit-sharing or stock bonus plans generally may permit the withdrawal of employer contributions after the expiration of a stated period of time (2 years or longer) or after the occurrence of a stated event (e.g., hardship). Hardship distributions may also be permitted under a tax-sheltered annuity investing in a mutual fund. Plans to which the less restrictive withdrawal rules apply have been sometimes referred to as capital accumulation or savings plans.

Special restrictions apply to benefits under a qualified cash or deferred arrangement (a plan that is part of a profit-sharing, stock bonus, or pre-ERISA money purchase pension plan and that meets the requirements of sec. 401(k)). Generally, except for hardship, these benefits may not be withdrawn before an employee attains age 59½, separates from service, dies, or becomes disabled.

The Code does not provide restrictions on benefit distributions under most private nonqualified plans of deferred compensation. However, benefits under unfunded deferred compensation plans of State or local governments and of certain tax-exempt organizations are not permitted to be made available earlier than when the employee separates from service or is faced with an unforeseeable emergency.

The labor law provisions of ERISA contain no restrictions on benefit distributions.

Prerequisite for nonretirement plan

Present law does not specify a distinction (other than withdrawal restrictions) between retirement plans and nonretirement savings plans and does not prevent an employer from establishing one type of plan for employees because the employer does not also provide another type of plan.

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[4] References to ERISA mean the Employee Retirement Income Security Act of 1974, and references to the Code mean the Internal Revenue Code of 1954.

Explanation of Provisions

Overview

The bill would establish two types of deferred compensation plans, retirement plans and nonretirement savings plans, which could be maintained by employers. Under the bill, an employer could provide a nonretirement savings plan for an employee only if that employee was also a participant in a retirement plan that provides a specified minimum benefit. In addition, a retirement plan would be required to meet certain retirement income requirements, which provide restrictions on in-service distributions from retirement plans and would provide restrictions on the form in which benefits could be paid under those plans.

Under the bill, a deferred compensation plan would be a nonretirement savings plan if it is not a retirement plan. The provisions with respect to retirement plans and nonretirement savings plans would be added to the Code and to the labor law.

In addition, under the bill, a retirement plan could not be converted by a plan amendment into a nonretirement savings plan.

Retirement income plans

Restrictions on time of distribution.—Generally, a plan would meet the restrictions of the bill relating to the time of benefit distributions (the retirement income requirements) only if the plan provides for distribution of the accrued benefits with respect to each participant commencing not earlier than specified times. Under the bill, accrued benefits generally could not be distributed under a retirement plan until (i) the participant's disability, (ii) the participant's death, or (iii) the later of the participant's attainment of age 59½, or separation from service. The retirement income requirements could also be met by a plan if the plan provides for certain direct transfers.

Under the bill, in the case of a participant who has separated from service and who has not attained age 59½, died or become disabled, a distribution may be made upon separation from service if the distribution meets certain requirements. The bill provides that the distribution could be made upon separation from service if it is in a retirement income form and if the benefits will be paid no later than the time permitted by the bill.

The bill would require that the payment of benefits commence not later than the later of (1) the end of the plan year in which the employee attains age 70½, or (2) in the case of an employee other than an owner-employee (sec. 401(c)(3) of the Code), the end of the plan year in which the employee retires.

Restrictions on benefit forms.—The bill specifies three forms of benefit distribution (retirement income forms) that would satisfy the restrictions on the form in which benefits may be distributed upon separation from service to a participant who has not attained age 59½, died, or become disabled. Under the bill, the distribution may be made (1) in the form of an annuity for the life of the participant, (2) in the form of a qualified joint and survivor annuity (as defined in sec. 205(d) of ERISA or sec. 417(b) of the Code), or (3) in the form of a level distribution over life expectancy (which may be adjusted not more frequently than annually to account for changes in life expectancy and reasonable assumptions based on previous investment performance under the plan).

Under the bill, a distribution would not fail to be in a retirement income form merely because the distribution is adjusted to allow for periodic supplements that terminate upon commencement of entitlement to benefits under the Social Security Act (e.g., a social security supplement), and after adding benefits otherwise paid under the plan for periods for which such supplements are paid, do not exceed the amount of those projected benefits under the Social Security Act and the plan upon the commencement of entitlement.

The bill would also permit the distribution of certain sickness, accident, or disability benefits (sec. 3(1) of ERISA).

Direct transfers.—The bill provides that a plan would not be treated as failing to meet the retirement income requirements solely because the plan provides for a direct transfer, to an IRA or to another retirement plan that accepts such direct transfers, of the accrued benefit with respect to the participant upon the participant's separation from service under the plan. See, also, part H.1., which describes provisions of the bill permitting certain direct transfers to an IRA without the participant's consent.

Nonretirement savings plans

Under the bill, a defined contribution plan that does not meet the requirements for status as a retirement plan would be a nonretirement savings plan. The bill would prohibit an employer from maintaining a nonretirement savings plan for an employee unless the employee participates in at least one retirement plan (a prerequisite plan) that meets specified requirements.

If the prerequisite plan is a defined benefit pension plan, then the bill would require that the defined benefit pension plan provide the participant with an accrued benefit equivalent to a specified amount. The bill provides that the specified amount would be determined by multiplying one-half of one percent by the product of (1) the amount of the participant's compensation (sec. 415 of the Code), and (2) the number of the participant's years of plan participation (sec. 411 of the Code).

The bill provides that if the prerequisite plan is a defined contribution plan, then the employer contribution with respect to each participant for each plan year must not be less than 3 percent of the participant's compensation (sec. 415 of the Code) for the plan year.

2. Coverage requirements (secs. 103 and 203 of the bill, secs. 202 and 212 of ERISA, and secs. 401, 409B, and 410 of the Code)

Present Law

The coverage requirements applicable to qualified plans (Code sec. 410(b)) require that a plan cover employees in general rather than merely the employer's top-ranking employees. A plan generally satisfies the present-law coverage rule if (1) it benefits a significant percentage of the employer's workforce (percentage test), or (2) it benefits a classification of employees determined by the Secretary of the Treasury not to discriminate in favor of employees who are officers, shareholders, or highly compensated (fair cross-section test). Present law does not require that an employer cover all employees (other than excludable employees).

Under present law, the coverage requirements do not apply under ERISA.

Percentage test

A plan meets the percentage test if (1) it benefits at least 70 percent of all employees, or (2) it benefits at least 80 percent of the employees eligible to benefit under the plan and at least 70 percent of all employees are eligible (i.e., the plan benefits at least 56 percent of all employees).

Fair cross-section test

A plan meets the fair cross-section test if the Secretary of the Treasury determines that it covers a classification of employees that is found not to discriminate in favor of employees who are officers, shareholders, or highly compensated. In making that determination, the Secretary is required to consider all the surrounding facts and circumstances, allowing for a reasonable difference between the ratio of highly compensated employees who are benefited by the plan to all such employees and the corresponding ratio calculated for employees who are not highly compensated.

Aggregation rules

Controlled groups.—In applying the qualification rules (including both the percentage and fair cross-section coverage tests), all employees of corporations that are members of a controlled group of corporations, or all employees of trades and businesses (whether or not incorporated) that are under common control, are aggregated and treated as if employed by a single employer (Code sec. 414(b) and (c)).

Affiliated service groups.—All employees of employers that are members of an affiliated service group of employers are treated as employed by a single employer for purposes of the qualification requirements (Code sec. 414(m)). An affiliated service group consists of a service organization (the "first organization") and (1) each other service organization that is related to the first organization and (2) each other service organization that is related to either the first organization, or to a service organization that is related to the first organization. In determining whether a group of employers constitutes an affiliated service group, certain attribution rules apply.

Employee leasing arrangements.—For purposes of certain of the tax-law rules for qualified plans and SEPs, an individual (a leased employee) who performs services for another person (the recipient) is treated as the recipient's employee if the services are performed pursuant to an agreement between the recipient and a third person (the leasing organization) who has contracted with the recipient for the individual's service (Code sec. 414(n)). The individual is treated as the recipient's employee only if the individual has performed services for the recipient (or for the recipient and persons related to the recipient) on a substantially full-time basis for a period of at least 12 months, and if the services are of a type historically performed by employees in the recipient's business field.

However, under a safe-harbor provision, an individual who otherwise would be treated as a recipient's employee pursuant to these rules is not treated as such an employee if certain requirements are met with respect to contributions provided for the individual under a qualified money purchase pension plan maintained by the leasing organization. The safe-harbor rule is inapplicable to a leased employee who is otherwise a common-law employee of the recipient.

Other aggregation.—The Secretary of the Treasury also has the regulatory authority to develop any rules as may be necessary to prevent the avoidance of any employee benefit requirement to which the employee leasing or affiliated service group provisions apply through the use of employee leasing or other arrangements (Code sec. 414(o)).

Excludable employees

In applying the percentage test, certain employees who have not yet completed minimum periods of service (generally one year[5]) and employees who have not yet attained age 21 may be disregarded if they are excluded pursuant to a plan provision. In addition, in applying both the percentage and the fair cross-section test, employees included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives[6] and one or more employees are disregarded if they are excluded pursuant to a plan provision and there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and the employer or employers (Code sec. 410(b)(3)(A)). Certain nonresident aliens and certain airline employees must be excluded from consideration (Code sec. 410(b)(3) (B) and (C)).

Tax-sheltered annuities

Under present law, no coverage or nondiscrimination rules apply to prohibit an employer's tax-sheltered annuity program from favoring highly compensated employees.

Explanation of Provisions

In general

The bill would revise the coverage requirements applicable to qualified plans under the Code and would extend those requirements to apply to all pension plans subject to ERISA.

Under the bill, an employer would be considered to meet the coverage requirements if each employee in the employer's relevant workforce whose compensation is less than the social security contribution and benefit base (i.e., the wage base) is eligible to participate in a retirement plan maintained by the employer.

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[5] Under a special rule, an employee may be excluded from participation for up to three years provided the employee is, after three years, fully and immediately vested.

[6] An organization is not considered to be an employee representative if more than one-half of its members participating in the plan are employees who are also owners, officers, or executives of the employer.

The bill provides that the coverage requirements would not limit the application of the general nondiscrimination rules applicable to qualified plans (sec. 401(a)(4) of the Code).

Special rules for subdivisions

Under the bill, if the relevant workforce of the employer consists of two or more allowable subdivisions, the coverage requirements would be considered to be met if two tests are met.

Under the first test, all employees in each allowable subdivision who earn less than the social security wage base would be required to be eligible to participate in a retirement plan maintained by the employer. This first test would not apply to an allowable subdivision if no employee in the allowable subdivision is eligible to participate in a retirement plan maintained by the employer.

The second test would apply to all employees of the employer (not merely to employees within an allowable subdivision). This test would be met if the percentage of the relevant workforce (the coverage percentage) of employees who (1) earn less than the social security wage base ($42,000 for 1986), and (2) are eligible to participate in a retirement plan maintained by the employer is at least 80 percent as of the end of the last fiscal year of the employer. Alternatively, the second test would be satisfied if the average of the coverage percentages as of the end of each of the last 5 fiscal years of the employer (or all preceding fiscal years of the employer, if less than 5) is at least 80 percent.

Multiple plans of an employer

Under the bill, the coverage requirements (to the extent that they require an employer to maintain a retirement plan) would be met if the employer maintained more than one plan and if each employee is eligible to participate in at least one retirement plan of the employer.

Rules for contributory plans

In the case of a plan that provides for mandatory employee contributions, the coverage requirements would be met only if, in addition to meeting the general coverage requirements, at least 60 percent of the employees who are eligible to participate actually benefit under the plan. Under the bill, the 60 percent test would be increased to 70 percent in the case of a retirement plan that is maintained as a prerequisite for a nonretirement savings plan.

Under the bill, the term "mandatory contributions" would mean amounts contributed to the plan by a participant that are required as a condition of employment, as a condition of participation in the plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.

Modification of minimum participation standards

The bill would repeal the present-law rule under which an employee may be required to complete three years of service before becoming eligible to participate in a plan maintained by an employer as long as the plan provides for full and immediate vesting upon plan participation.

Definitions

Relevant workforce.—Under the bill (as under present law), the term relevant workforce would mean all employees of an employer other than certain excludable employees. An excludable employee would include the following employees:

(1) Employees who have not met the minimum age or service requirements, if any, for participation in any pension, profit-sharing, or stock bonus plan established or maintained by the employer;

(2) Employees who do not participate in any pension, profit-sharing, or stock bonus plan established or maintained by an employer and who are included in a unit of employees covered by an agreement that the Secretary finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers;

(3) Employees who are included in a unit of employees covered by an agreement pursuant to which a pension, profit-sharing, or stock bonus plan is maintained by the employer and that the Secretary finds to be a collective-bargaining agreement between airline pilots and one or more employers (unless the principal duties of such employee are not customarily performed aboard aircraft in flight); or

(4) Employees who are nonresident aliens and who receive no earned income from the employer that constitutes U.S. earned income.

Allowable subdivision.—The bill would define the term allowable subdivision to mean the portion of the relevant workforce of the employer that serves in a separate business unit as defined in Treasury regulations distinguishing such business unit solely on the basis of its distinct locality or its separate product line. Further, the bill would define an allowable subdivision to include the portion of the relevant workforce of the employer that does not serve in the workforce of any such separate business unit.

D. Limitations on Deductions, Contributions, and Benefits (secs. 111, 112, 211, 212, 213, 214, and 215 of the bill, secs. 214 and 306 of ERISA, and secs. 72, 219, 401, 402, and 415 of the Code

Present Law

Individual retirement accounts and annuities

The individual retirement savings provisions of the Code were originally enacted in ERISA to provide a tax-favored retirement savings arrangement to individuals who were not covered under a qualified plan or a governmental plan maintained by the employer. Those who were active participants in employer plans were not permitted to make deductible IRA contributions.

In the Economic Recovery Tax Act of 1981 (ERTA), Congress eliminated the provision restricting IRA eligibility to individuals who were not active participants and increased both the dollar and percentage of compensation limitations, from the lesser of 25 percent of compensation or $1,500, to the lesser of 100 percent of compensation or $2,000. In addition, ERTA provided rules permitting deductible employee contributions (or qualified voluntary employee contributions) to be made to a qualified plan.

Under present law (Code sec. 219), an individual generally is entitled to deduct from gross income the amount contributed to an IRA (within limits). The limit on the deduction for a taxable year generally is the lesser of $2,000 or 100 percent of compensation (earned income, in the case of income from self-employment). Similar rules apply with respect to qualified voluntary employee contributions made by an employee under a qualified plan. To the extent that a deduction is allowed to an individual for a year with respect to a qualified voluntary employee contribution, the limit for the year on deductions for a contribution to an IRA is reduced.

Cash or deferred arrangements (401(k) plans)

In general

Before the enactment of ERISA, some employers permitted employees to decide whether to accept compensation in cash or defer the compensation by having the employer contribute it to a profit-sharing plan. The Internal Revenue Service raised questions as to whether, under the usual tax principles of constructive receipt, employees who could have received cash, but chose to defer compensation, should be taxed as though they had received the cash. ERISA provided a limited moratorium on the issuance of Treasury regulations and IRS rulings relating to the application of the constructive receipt rule to employee deferrals under qualified plans. The moratorium was extended through 1978, when Congress enacted special rules relating to qualified cash or deferred arrangements (also referred to as CODAs or sec. 401(k) plans). Under those rules, if the requirements of the Code are met, an employee can choose deferral of compensation (within limits) without being taxed as though the compensation had been received.

If a tax-qualified profit-sharing or stock bonus plan (or certain pre-ERISA money purchase pension plans) meets certain requirements described below (a "qualified cash or deferred arrangement"), then an employee is not required to include in income any employer contributions to the plan merely because the employee could have elected to receive the amount contributed in cash.

Nondiscrimination requirements

The amount a highly paid employee can elect to defer, tax free, under a qualified cash or deferred arrangement depends (in part) on the level of elective deferrals by other employees. Special nondiscrimination tests apply a limit on elective deferrals by the group of highly paid employees that is determined by reference to deferrals by other employees. An employee is considered highly paid, for this purpose, if the employee is more highly compensated than ⅔ of all of the eligible employees. These nondiscrimination tests provide that the special treatment of elective deferrals is not available unless the cash or deferred arrangement does not disproportionately benefit highly paid employees.

The tests are based on the relationship of the actual deferral percentage for the group of highly paid employees to the actual deferral percentage for the group of other eligible employees. The deferral percentage for an employee for a year is the percentage of that employee's compensation that has been electively deferred for the year. The actual deferral percentage for a group of employees is the sum of the deferral percentages for the employees divided by the number of employees in the group eligible to defer.

A cash or deferred arrangement meets these special nondiscrimination requirements for a plan year if (1) the actual deferral percentage for the highly paid employees does not exceed the actual deferral percentage of the other eligible employees by more than 150 percent, or (2) the actual deferral percentage for the highly paid employees does not exceed the actual deferral percentage of the other eligible employees by more than three percentage points. If the three percent test is used, the actual deferral percentage for the highly paid employees also cannot exceed the actual deferral percentage of all other eligible employees by more than 250 percent. In calculating these deferral percentages, contributions by the employer that (1) are nonforfeitable when made and (2) satisfy the withdrawal restrictions applicable to elective deferrals may be taken into account as elective deferrals by employees.

The special nondiscrimination tests applicable to cash or deferred arrangements apply in lieu of the usual nondiscrimination rules for qualified plans, which permit employer contributions to social security to be taken into account. These special nondiscrimination rules do not replace, however, the usual rules requiring that a qualified plan cover either a specified percentage of employees or a fair cross-section of employees.

Withdrawal restrictions

Under present law, a participant in a qualified cash or deferred arrangement is not permitted to withdraw elective deferrals (and earnings thereon) prior to age 59½, death, disability, separation from service, retirement, or the occurrence of a hardship. What constitutes the occurrence of a hardship under present law has not been defined except in proposed regulations.

Limit on elective deferrals

Elective deferrals under a qualified cash or deferred arrangement are subject to the overall limits on contributions to a defined contribution plan. Thus, under present law, the elective deferrals made by a participant, together with all other annual additions made to any plan of the employer on behalf of the participant, generally cannot exceed the lesser of $30,000 or 25 percent of the participant's nondeferred compensation.

Limits on contributions and benefits under qualified plans

In general

ERISA added overall limits on contributions and benefits under qualified plans and tax-sheltered annuities (Code sec. 415). The overall limits apply to contributions and benefits provided to an individual under all qualified plans, tax-sheltered annuities, and simplified employee plans (SEPs) maintained by any private or public employer or by certain related employers. The limits provided by ERISA were automatically adjusted for inflation. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced the limits and suspended cost-of-living increases. The Deficit Reduction Act of 1984 further suspended cost-of-living increases through 1987.

Defined contribution plans

Under a defined contribution plan, an overall limit applies to the annual addition with respect to each plan participant (Code sec. 415(c)). As originally enacted, the annual addition (consisting of employer contributions, certain employee contributions, and forfeitures allocated from the accounts of other participants) generally was limited to the lesser of (1) 25 percent of compensation for the year, or (2) $25,000, adjusted for cost-of-living increases, as measured by the changes in the consumer price index (CPI) since 1974. By 1982, the dollar limit, as increased to reflect cost-of-living adjustments, was $45,475. In 1982, TEFRA reduced the dollar limit from $45,475 to $30,000.

Defined benefit pension plans

Under a defined benefit pension plan, the limit on the annual benefit derived from employer contributions adopted in ERISA was the lesser of (1) 100 percent of average compensation, or (2) $75,000, adjusted for cost-of-living increases, as measured by the CPI since 1974. By 1982, the dollar limit on annual benefits, as increased to reflect cost-of-living adjustments, was $136,425. In 1982, TEFRA reduced that dollar limit from $136,425 to $90,000.

Prior to TEFRA, the annual benefit generally was the equivalent of an annuity for the life of the participant, beginning at age 55 or later, and determined without regard to certain survivor and nonretirement benefits. If retirement benefits commenced before age 55, the dollar limit was actuarially reduced. TEFRA provided that the new $90,000 limit (but not the 100 percent of compensation limit) is reduced if benefits commence before age 62 (rather than age 55). Thus, for benefits commencing before age 62, the $90,000 limit generally is reduced so that it is the actuarial equivalent of an annual benefit of $90,000 commencing at age 62. In no event, however, is the dollar limit applicable to benefits commencing at or after age 55 less than $75,000. If retirement benefits commence before age 55, the dollar limit is actuarially reduced so that it is the actuarial equivalent of a $75,000 annual benefit commencing at age 55.

The Code provides that reduced limits apply to participants with fewer than ten years of service. The limits are reduced by ten percent per year for each year of service less than ten. For example, benefits commencing at or after age 62 with respect to a participant who had only three years of service could not exceed 3/10 of $90,000 ($27,000).

Employee contributions

Under the Code, only a portion of nondeductible employee contributions to a qualified plan is taken into account in applying the overall limits. The amount taken into account is the lesser of one-half of the employee contributions or total employee contributions in excess of six percent of compensation. Therefore, if total employee contributions do not exceed six percent of compensation, no employee contributions are counted as annual additions.

Combined plan limit

The Code also provides an aggregate limit applicable to employees who participate in more than one type of plan maintained by the sam[illegible]mployer.

If an employee participates in a defined contribution plan and a defined benefit pension plan maintained by the same employer, the fraction of the separate limit used for the employee by each plan is computed and the sum of the fractions is subject to an overall limit (Code sec. 415(e)). As originally enacted, the sum of the fractions was limited to 1.4. In 1982, TEFRA redefined the fractions and limited the sum of the two fractions to 1.0. Although the sum of the fractions is 1.0, adjustments made to the denominators of the revised fractions effectively provide an aggregate limit of the lesser of 1.25 (as applied to the dollar limits) or 1.4 (as applied to the percentage of compensation limits).

Aggregate limit on contributions and benefits for key employees in a top-heavy plan

Under present law, the combined plan limit may be reduced for an employee who participates in both a defined benefit pension plan and a defined contribution plan one of which is top heavy. Unless certain requirements are met, for any year for which one of the plans is top heavy, the new fractions are modified, effectvely providing the employee with an aggregate limit equal to the lesser of 1.0 (as applied to the dollar limits) or 1.4 (as applied to the percentage of compensation limits).

These modifications do not apply if the plans of the employer in which the employee participates (1) are not super top heavy (i.e., do not provide more than 90 percent of the benefits for key employees), and (2) provide either an extra minimum benefit (in the case of the defined benefit pension plan) or an extra minimum contribution (in the case of the defined contribution plan) for non-key employees participating in the plans.

Tax-sheltered annuities

The amount paid by an employer under a tax-sheltered annuity is excluded from the employee's income for the taxable year to the extent that the payment does not exceed the employee's exclusion allowance for the taxable year. The exclusion allowance is generally equal to 20 percent of the employee's includible compensation from the employer multiplied by the number of the employee's years of service with that employer, reduced by amounts already paid by the employer to purchase the annuity.

Employer payments to purchase a tax-sheltered annuity contract for an employee are also subject to the overall limits on contributions and benefits under qualified plans (Code sec. 415). Tax-sheltered annuities are generally defined contribution arrangements.[7] Under the overall limits, annual additions to tax-sheltered annuities and other defined contribution arrangements for the employee may not exceed the lesser of $30,000 or 25 percent of the employee's compensation from the employer for the year. Under a special rule (Code sec. 415(c)(4)(C)), an employee of an educational institution, hospital, home health service agency, or church may elect to compute the annual exclusion allowance for payments under a tax-sheltered annuity solely by reference to the maximum annual employer payment that could be made under the overall limit.

In addition, to allow certain lower-paid employees catch-up payments (i.e., payments permitted under the exclusion allowance on account of prior years of service, but denied under the overall annual limit that takes into account only the current year), alternative special elections are provided to increase the overall limit for the year of the election. An individual is allowed only one of the special election under section 415.[8]

In addition, a church employee may make an additional election pursuant to which the church may make payments for the year in excess of the otherwise applicable overall annual limit.[9] The election may not be made for the same year in which a catch-up election is effective.

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[7] The Economic Recovery Tax Act of 1981 (ERTA) provided that a church-maintained retirement income program in existence on September 3, 1982, will not be considered as failing to satisfy the requirements for a tax-sheltered annuity (Code sec. 403(b)) merely because the program is a defined benefit pension plan (Code sec. 414(j)).

[8] The first alternative catch-up election (Code sec. 415(c)(4)(A)) may be made only for the year of an employee's separation from the service of the contributing employer (the separation year catch-up election). The second alternative catch-up election (Code sec. 415(c)(4)(B)) generally may be made for any year, but is subject to additional limitations. Neither election increases the amount excludable from the employee's income for the year under the exclusion allowance.

[9] The employee's election increases the overall annual limits (subject to the employee's exclusion allowance) to the lesser of (1) the amount paid by the church for the year, or (2) $10,000. Employer payments permitted for a church employee under this provision (i.e., payments in excess of the otherwise applicable annual limits) may not exceed $40,000 for the employee's lifetime.

Explanation of Provisions

In general

The bill would restrict the deduction for qualified voluntary employee contributions made by plan participants. Under the bill, the deduction would be allowed only for a contribution to a retirement plan.

The bill would revise the rules of the Code providing for qualified cash or deferred arrangements (401(k) plans) and would provide corresponding labor law rules. Under the bill, a cash or deferred arrangement could be provided only by a retirement plan that meets specified requirements relating to the coverage of employees. The bill would coordinate the exclusion provided for elective deferrals under a 401(k) plan with the deduction allowed to an employee for contributions to an IRA. Under the bill, the deduction limit for contributions to an IRA would be reduced by the amount of elective deferrals under a 401(k) plan.

Under the bill, the overall limits on contributions and benefits under qualified plans would be revised. The bill would provide further reductions for contributions and benefits under nonretirement plans. In addition, the bill would limit the amount of compensation that may be taken into account under a qualified plan for purposes of determining whether benefits and contributions under a plan meet the requirements of the Code. A corresponding limit on compensation taken into account would be provided by the bill under labor law.

Finally, the bill would repeal the combined limit that applies if an employee participates in more than one plan of the employer unless one of the plans in which the employee participates is top heavy.

Qualified voluntary employee contributions

Under the bill, a voluntary employee contribution to a plan would not be deductible unless it is made to a retirement plan. For rules defining retirement plans under the bill, see part C., above.

Cash or deferred arrangements (401(k) plans)

In general

The bill would restrict cash or deferred arrangements to retirement plans. Accordingly, under the bill, a pension, profit-sharing, or stock bonus plan could not provide a cash or deferred arrangement unless the plan meets the requirements for status as a retirement plan (see part C., above).

The bill defines a cash or deferred arrangement as any arrangement that is part of a plan and under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash. Accordingly, under the bill, a cash or deferred arrangement could be maintained under a pension plan (including a defined benefit pension plan) that is a retirement plan. The bill would continue present law under which an employee's right to the accrued benefit derived from employer contributions with respect to employee deferrals under a cash or deferred arrangement is required to be nonforfeitable.

The changes made under the bill with respect to cash or deferred arrangements would also apply for labor law purposes.

Relationship of deferral percentages

The bill would continue present law under which a cash or deferred arrangement would not be treated as meeting the requirements of the Code unless the actual deferral percentage for highly compensated employees for a plan year bears a specified relationship to the actual deferral percentage for all other eligible employees for that year. Under the bill, as under present law, an arrangement may meet a 1.5 multiplier test or a 2.5 multiplier test. The bill would continue the rules of present law with respect to employers who maintain 2 or more plans that include cash or deferred arrangements and for employees who participate in more than one cash or deferred arrangement of an employer.

The bill would provide for application of the nondiscrimination tests for cash or deferred arrangements on the basis of allowable subdivisions of an employer's employees (see part C., above, for a definition of allowable subdivisions). Under the bill, in the case of any plan that would not meet the retirement income requirements without the application of the provisions of the bill relating to allowable subdivisions, the tests for cash or deferred arrangements would be applied on the basis of each separate allowable subdivision.

Coordination with individual retirement accounts and annuities

The bill would provide rules coordinating the level of deductible contributions to individual retirement accounts and individual retirement annuities (IRAs) with elective deferrals under qualified cash or deferred arangements. The bill would continue the rules of present law under which the limit on deductible contributions to IRAs are coordinated with qualified voluntary employee contributions.

Under the bill, if an individual makes elective deferrals under a cash or deferred arrangement that is a retirement plan, then the amount of the IRA contributions which are paid for the taxable year and which are allowable as a deduction is to be reduced by the amount of the individual's elective deferrals under the cash or deferred arrangement.

Wage-based limits on contributions and benefits

In general

The bill would limit the amount of compensation taken into account for purposes of applying the nondiscrimination and integration rules applicable under the Code and under ERISA and for purposes of computing the overall limits on contributions and benefits. The bill would also modify the separate limits with respect to defined benefit pension plans and defined contribution plans. Reduced limits would apply to a nonretirement savings plan. The combined limit applicable to an employee who participates both in a defined benefit pension plan and a defined contribution plan of the same employer would be applied only if at least one of the plans in which the employee participates is top heavy. These limits would also apply to tax-sheltered annuities.

Under the bill, the dollar limit for a defined benefit pension plan would be 200 percent of the contribution and benefit base under the Social Security Act. For a defined contribution plan that is a retirement plan, the bill would provide a dollar limit of 50 percent of the contribution and benefit base under the Social Security Act.

For a nonretirement savings plan, the bill would provide a limit of the lesser of 25 percent of the contribution and benefit base under the Social Security Act or 10 percent of the participant's compensation.

The limit on elective deferrals under a cash or deferred arrangement would be reduced to 25 percent of the contribution or benefit base under the Social Security Act.

Compensation taken into account

The bill would provide a limit on the level of compensation taken into account in applying the overall limits and for purposes of the nondiscrimination and integration rules under the Code and the labor law. Under the bill, the compensation taken into account would be limited to 500 percent of the contribution and benefit base under the Social Security Act (the compensation limit would be $210,000 if it applied in 1986).

Defined benefit pension plans

The bill would provide that the limit applicable to the annual benefit under a defined benefit pension plan is the lesser of 200 percent of the contribution and benefit base under the Social Security Act (the limit on the annual benefit would be $84,000 if the bill applied in 1986) or 100 percent of the participant's high 3-year average compensation. Because the limit on annual benefits would be linked directly to the contribution and benefit base under the Social Security Act, the limit for a year would be automatically adjusted for inflation when the contribution and benefit base under the Social Security Act is adjusted.

Defined contribution plans

For a defined contribution plan that is a retirement plan, the bill would generally limit the annual addition to the lesser of 50 percent of the contribution and benefit base under the Social Security Act ($21,000 if the bill applied in 1986) or 20 percent of compensation.

The bill would provide that the annual addition under a nonretirement savings plan is the lesser of 25 percent of the contribution and benefit base under the Social Security Act ($10,500 if the bill applied in 1986) or 10 percent of compensation.

The bill would modify the definition of the annual addition by eliminating the exclusion for employee contributions of less than 6 percent of compensation. Accordingly, under the bill, one-half of all employee contributions would be taken into account in computing the annual addition.

Cash-or-deferred arrangements

Under the bill, an employee's elective deferral under a cash or deferred arrangement would be limited to the lesser of 25 percent of the contribution and benefit base under the Social Security Act ($10,500 if it applied in 1986) or 20 percent of compensation.

Combined limits

Although the bill would continue to apply separate dollar and percentage limits to defined benefit pension plans and defined contribution plans, the special limit on combined plans would be repealed if no plan in which an employee participates is top heavy.

E. Vesting Standards (secs. 121 and 221 of the bill, sec. 203 of ERISA, and sec. 411 of the Code)

Present Law

In general

Prior to the enactment of ERISA, a qualified plan was required to provide vested (i.e., nonforfeitable) rights to employees when they attained the normal or stated retirement age. Qualified plans were also required to vest employees upon plan termination or the discontinuance of employer contributions. However, no preretirement vesting was required unless the absence of such vesting caused discrimination in favor of officers, shareholders, supervisors, or highly compensated employees.

To ensure that employees with substantial periods of service with the employer do not lose plan benefits upon separation from employment, ERISA and the Code generally require that (1) a participant's benefits be fully vested upon attainment of normal retirement age under the plan; (2) a participant be fully vested at all times in the benefit derived from employee contributions; and (3) employer-provided benefits vest at least as rapidly as under one of 3 alternative minimum vesting schedules (Code sec. 411(a)). Under these schedules, an employee's right to benefits derived from employer contributions becomes nonforfeitable (vested) to varying degrees upon completion of specified periods of service with an employer.

Under one of the schedules, full vesting is required upon completion of 10 years of service (no vesting is required before the end of the 10th year). Under a second schedule, vesting begins at 25 percent after completion of 5 years of service and increases gradually to 100 percent after completion of 15 years of service. The third schedule takes both age and service into account, but, in any event, requires 50-percent vesting after 10 years of service, and an additional 10-percent vesting for each additional year of service until 100-percent vesting is attained after 15 years of service.

Patterns of discrimination

Prior to ERISA, preretirement vesting was sometimes required under a qualified plan to prevent discrimination. Although ERISA required all plans to meet certain minimum preretirement vesting standards, ERISA also provided that earlier vesting may still be required under a qualified plan to prevent discrimination if (1) there has been a pattern of abuse under the plan tending to discriminate in favor of employees who are officers, shareholders, or highly compensated; or (2) there has been, or there is reason to believe there will be, an accrual of benefits or forfeitures tending to discriminate in favor of employees who are officers, shareholders, or highly compensated (Code sec. 411(d)(1)).

Top-heavy plans

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) required earlier preretirement vesting for certain top-heavy plans to improve the likelihood that covered participants would receive benefits.[10] For any plan year for which a qualified plan is top heavy, an employee's right to accrued benefits must become nonforfeitable under one of 2 alternative schedules. Under the first top-heavy schedule, a participant who has completed at least 3 years of service with the employer maintaining the plan must have a nonforfeitable right to 100 percent of the accrued benefit derived from employer contributions.

A plan satisfies the second alternative (6-year, graded vesting) if a participant has a nonforfeitable right to at least 20 percent of the accrued benefit derived from employer contributions at the end of 2 years of service, 40 percent at the end of 3 years of service, 60 percent at the end of 4 years of service, 80 percent at the end of 5 years of services, and 100 percent at the end of 6 years of service with the employer.

Class year plans

Special vesting rules also apply to "class year plans." A class year plan is a profit-sharing or stock bonus plan that provides for the separate vesting of employee rights to employer contributions on a year-by-year basis. The minimum vesting requirements are satisfied if the plan provides that a participant's right to amounts attributable to employer contributions with respect to any plan year are nonforfeitable not later than the close of the fifth plan year following the plan year for which the contribution was made.

Explanation of Provision

The bill would amend ERISA and the Code to require that, in the case of a retirement plan, a participant who has completed at least 5 years of service have a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions. As an exception to this rule, the bill requires that in the case of a multiemployer plan that is a retirement plan a participant in the plan who has completed at least 10 years of service have a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions.

Explanation of Provision

The bill would amend ERISA and the Code to require that, in the case of a retirement plan, a participant who has completed at least 5 years of service have a nonforfeitable rigfht to 100 percent of the participant's accrued benefit derived from employer contributions. As an exception to this rule, the bill requires that in the case of a multiemployer plan that is a retirement plan.

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[10] A top-heavy plan is a qualified plan under which more than 60 percent of the benefits are provided for key employees (Code sec. 416).

The bill would amend the Code and ERISA to require that in the case of a nonretirement savings plan, a participant who has completed at least one year of service has a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions.

The provisions apply with respect to participants who have completed at least one hour of service on or after the date of enactment.

F. Pension Integration (secs. 131 and 231 of the bill, sec. 215 of ERISA, and sec. 401(1) of the Code)

Present Law

In general

The Code provides nondiscrimination standards for qualified pension, profit-sharing, and stock bonus plans. These standards prohibit discrimination in favor of employees who are officers, shareholders, or highly compensated. Under these standards, coverage tests are applied to determine whether the classification of employees who participate in a plan is discriminatory. Additional tests are applied to determine whether contributions or benefits under the plan discriminate in favor of highly compensated employees.

The rules prohibiting discrimination under qualified plans were adopted by the Congress in 1942. The nondiscrimination standard was adopted to "safeguard the public against the use of the pension plan as a tax-avoidance device by management groups seeking to compensate themselves without paying their appropriate taxes." [11] Congress was concerned that the requirement of nondiscriminatory coverage by a plan was not sufficient. Although nondiscriminatory coverage could assure that rank-and-file employees were not unfairly omitted from a plan, it could not assure that those employees would be provided with a fair share of benefits. Accordingly, the 1942 Act included standards requiring that a qualified plan provide nondiscriminatory benefits or contributions for plan participants. It was noted that even ". . . extended coverage would not by itself guarantee that the pension plan would be operated for the welfare of employees generally, because the scale of benefits could be manipulated. Therefore, the scale of benefits must be nondiscriminatory." [12] In determining whether benefits were discriminatory, the Congress noted that plans designed in good faith to supplement social security should be permitted to qualify for favorable tax treatment.[13] Thus, a plan that provides benefits which, when aggregated with employer-provided social security benefits, constitute a nondiscriminatory percentage of compensation is deemed to be nondiscriminatory even though plan benefits standing alone would not meet the nondiscrimination standard.

Integration of defined benefit pension plans

Generally, in applying the nondiscrimination test to benefits under a plan, the rate at which benefits are provided by the plan for highly compensated participants (as a percentage of their pay) is compared with the rate at which the plan provides benefits for other participants. A similar test may be applied to employer contributions under a plan. A plan fails the nondiscrimination standard if both benefits and contributions discriminate in favor of highly compensated employees.

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[11] H. Rpt. 77-2333, 77th Cong., 2d. Sess. 51 (1942).

[12] *Ibid.*

[13] See, e.g., S. Rpt. 1631, 77th Cong., 2d. Sess. 139 (1942).

Under present law, in determining whether defined benefit pension plan benefits, as a percentage of nondeferred pay, discriminate in favor of employees who are highly compensated, the portion of each employee's social security benefits that are considered to be paid for by the employer may be taken into account. For this purpose, social security benefits mean old age, survivors, and disability insurance (OASDI) benefits provided under the social security system.

A plan that meets the nondiscrimination standards of the Code only if social security benefits are taken into account is referred to as an integrated plan. If these social security benefits and the employer-provided benefits under the plan, when added together, provide an aggregate benefit that is a higher percentage of pay for highly compensated employees than for other employees, then the benefits under the plan are discriminatory and the plan does not qualify. Either benefits or contributions under a plan may be integrated.

Two basic approaches to integration of defined benefit pension plans have been developed—(1) the "offset" approach, and (2) the "excess" approach.[14]

Offset plans

A defined benefit pension plan that integrates under the offset approach is referred to as an offset plan. An offset plan initially provides each employee with an annual pension benefit which (as a percentage of pay) does not discriminate in favor of highly compensated employees. For each employee, this initial benefit is then reduced, or offset, by the employer-provided portion of that employee's social security benefit to arrive at the actual pension benefit under the plan.

In 1971, the Internal Revenue Service determined that the value of employer-provided social security benefits is equal to 83⅓ percent of the annualized primary insurance amount (PIA) to which an employee is entitled under the Social Security Act. This calculation forms the basis of the present-law rules for integrating offset plans. Consequently, an offset plan could integrate its benefits with social security by providing each employee an annual benefit of, for example, 50 percent of pay offset by 83⅓ percent of the employee's PIA.

Excess plans

A pension plan that integrates under the excess approach is referred to as an excess plan. The basic theory underlying the excess approach is that social security provides benefits based on only a certain portion of an employee's earnings. An excess plan is designed to provide benefits (or added benefits) based on the portion of an employee's earnings "in excess" of the earnings on which social security benefits are provided (covered compensation). An excess plan integrates if the benefits it provides with respect to compensation in excess of covered compensation are not greater, as a percentage of pay, than the benefits provided by social security on covered compensation.

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[14] Rules for integrating under these two approaches are set forth in Rev. Rul. 71-446, 1971-2 C.B. 187.

The Internal Revenue Service determined that the employer-provided portion of benefits under social security averages 37½ percent of the average maximum pay on which social security benefits are based. This calculation forms the basis of the present-law rules for integrating excess plans. Consequently, for an employee retiring at age 65 in 1986, an excess plan will integrate properly if it provides benefits at a rate no greater than 37½ percent of pay in excess of $15,000 (approximately the highest average annual wage upon which social security benefits can be based for such an employee), although it provides no benefits with respect to the first $15,000 of pay.

If an excess plan provides benefits on compensation up to covered compensation, then it can provide benefits at a higher rate on pay above the level of covered compensation. However, the rate at which benefits are provided above covered compensation cannot exceed the rate at which benefits are provided on compensation up to covered compensation by more than 37½ percent. For example, an integrated excess plan could provide benefits at the rate of 12½ percent for all compensation plus 50 percent (i.e., 37½ percent plus 12½ percent) of compensation in excess of covered compensation.

Integration of defined contribution plans

Defined contribution plans do not provide specified benefit formulas. Defined contribution plans provide for contributions to be allocated to and accumulated in a separate account for each employee. Accordingly, such plans are integrated by taking into account the employer-paid portion of social security taxes. Specifically, a defined contribution plan is integrated by reducing contributions to the plan with respect to the portion of an employee's pay subject to the social security tax (i.e., the taxable wage base).

Prior to 1984, the integration of a defined contribution plan was based on the IRS-calculated cost of employer-provided social security benefits. For pre-1984 years, the Internal Revenue Service had determined that the employer's cost of providing social security benefits was seven percent of pay subject to the tax.

Effective for plan years beginning after 1983, TEFRA revised the integration rules for profit-sharing and other defined contribution plans. TEFRA permits an employer to reduce plan contributions on behalf of an employee by no more than an amount equal to the employee's taxable wage base multiplied by the actual OASDI tax rate. Thus, a profit-sharing plan could provide contributions of 5.7 percent (the OASDI tax rate) of 1986 pay in excess of $42,000 (the 1986 taxable wage base) and no contributions for 1986 with respect to the first $42,000 of pay. Similarly, if a plan provided for 1986 contributions of 10 percent of pay in excess of $42,000, it would integrate properly only if it provided for 1986 contributions of at least 4.3 percent with respect to the first $42,000 of pay.

Top-heavy plans

A qualified plan that is top heavy must provide a minimum nonintegrated benefit or contribution derived from employer contributions for each employee who is a participant in the plan and who is not a key employee (sec. 416). The rule is designed to reflect the higher proportion of tax benefits focused on key employees in a top-heavy plan.[15]

A defined benefit pension plan satisfies this minimum benefit requirement if, on a cumulative basis, the accrued benefit of each participant who is not a key employee, when expressed as an annual retirement benefit, is not less than two percent of the employee's average annual compensation from the employer, multiplied by the employee's years of service with the employer. However, an employee's minimum benefit is not required to exceed 20 percent of such average annual compensation. This required minimum benefit may not be eliminated or reduced on account of the employee's social security benefits attributable to contributions by the employer (i.e., the minimum benefit is a "nonintegrated" benefit).

For a plan year for which a defined contribution plan is a top-heavy plan, the employer generally must contribute on behalf of each plan participant who is not a key employee an amount not less than three percent of the participant's compensation. The minimum contribution must be made for each year in which the plan is top heavy. However, special rules provide that if the employer's contribution rate for each participant who is a key employee for the plan year is less than three percent, then the required minimum contribution rate for each non-key employee generally is limited to the highest contribution rate for any key employee.

Amounts paid by the employer for the year to provide social security benefits for the employee are disregarded. Thus, the required minimum contribution for a non-key employee may not be eliminated or reduced on account of benefits attributable to social security taxes paid by the employer (i.e., the minimum contribution is a "nonintegrated" contribution).

Explanation of Provisions

In general

The bill would revise the integration rules under the Code for qualified plans and would add to labor law the prohibition applicable to qualified plans under present law against discrimination by a plan in favor of specified employees. Under the bill, a pension plan would not be considered to violate the nondiscrimination rules of the tax law or the labor law merely because the plan is integrated.

Certain discrimination prohibited by ERISA

The bill would extend to all plans subject to ERISA the present law nondiscrimination rule applicable to qualified plans. Under this rule, the contributions and benefits provided under a pension plan may not discriminate in favor of employees who are officers, shareholders, or highly compensated. Employees in certain collective bargaining units and certain nonresident aliens may be excluded from consideration in testing whether a plan meets the requirements of the prohibition against discrimination.

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[15] Generally, a plan is top heavy if more than 60 percent of the benefits it provides are for key employees (sec. 416).

Nondiscriminatory integration

The bill would provide that a plan would not violate the nondiscrimination rules of labor law or of the Code merely because it is an integrated plan. The bill defines an integrated plan as a plan that is discriminatory solely because it provides a contribution or benefit that meets specified requirements. The bill provides requirements for formulas under excess plans and under offset plans.

Excess plan requirements

Under the bill, the integration ratio of a plan is not to exceed the permitted level. In the case of a defined contribution plan, the integration ratio is a fraction (1) the numerator of which is the rate of employer contributions based on compensation up to the integration level, and (2) the denominator of which is the rate of employer contributions based on compensation in excess of that level. Under the bill, the minimum integration ratio of a plan is 50 percent. The bill defines the integration level of a plan as an amount that does not exceed the contribution or benefit base under the Social Security Act as of the beginning of the plan year ($42,000 for plan years beginning in 1986). The bill provides corresponding rules for benefits under defined benefit pension plans.

For example, a defined contribution plan would be considered to be integrated properly under the bill if the rate of contributions to the plan based on compensation at or below the wage base is at least 50 percent of the rate of contributions based on compensation in excess of the wage base. If a plan provided contributions to the plan at the rate of 10 percent for compensation in excess of $42,000 (the wage base for 1986), then the plan would be considered nondiscriminatory if the rate of contributions to the plan is at least 5 percent for compensation at or below $42,000.

The bill would authorize the Secretary of the Treasury to prescribe regulations requiring an increase in the minimum integration ratio under a defined benefit pension plan (or a class of defined benefit pension plans) to the extent necessary to eliminate any additional discrimination otherwise forbidden by the bill attributable solely to the value of the plan features (constituting the form of benefit, any preretirement benefits, the vesting schedule, the normal retirement age, and any actuarial adjustment factors) with respect to benefits attributable to compensation in excess of the specified integration level, taking into account the value of such features with respect to benefits attributable to compensation not in excess of the specified integration level.

The bill would also authorize the Secretary of the Treasury to prescribe regulations requiring increases in the minimum integration ratio under a defined benefit pension plan (or a class of defined benefit pension plans) that provides for mandatory employee contributions (sec. 411(c)(2)(C) of the Code and sec. 212(e)(4) of

ERISA) to the extent necessary to eliminate any additional discrimination otherwise prohibited by the bill attributable solely to the ratio which employee contribution rates applicable to compensation which is not in excess of the integration level bears to employee contribution rates applicable to compensation which is in excess of that level.

Offset plan requirements

Under the bill, the contribution or benefit formula of a plan meets the offset plan requirements if, under that formula, to the extent consistent with requirements of the bill relating to minimum benefits, the normal retirement benefit with respect to each participant is expressed in the form of a benefit which is a specified percentage of compensation, reduced by the permitted offset. Under the bill, the permitted offset is a percentage specified by the plan (not more than 100 percent) of the primary insurance amount (sec. 215 of the Social Security Act) of the participant (or any other individual on whose wages and self-employment income the participant's entitlement to monthly social security benefits is based), determined as of the earlier of the date of the commencement of the participant's entitlement to benefits under the Social Security Act or the date of the participant's separation from service.

Under the bill, the benefit requirement for an offset plan is met if the accrued benefit derived from employer contributions (sec. 411(a)(7) of the Code and sec. 204(c)(1) of ERISA) provided to each participant is not less than 50 percent of the accrued benefit that would be derived from employer contributions if the plan did not take social security benefits into account.

The bill limits the authority of the Secretary to prescribe regulations relating to the criteria for determining whether the requirements relating to the offset formula are satisfied. Under the bill, in any regulations prescribed by the Secretary for purposes of determining whether the offset plan requirements have been met, the form of benefit, preretirement benefits, or similar plan provisions are not to be taken into account.

Treatment of multiple plans

The bill would provide that, for purposes of the integration rules, if an employee is eligible to participate in 2 or more retirement plans that are maintained by the same employer, the plans are to be treated as a single plan with respect to the employee.

G. Distributions (Secs. 241 and 242 of the bill and secs. 402, 403, and 408 of the Code)

Present Law

Lump-sum distributions

Under present law, a lump-sum distribution from a qualified plan may qualify for special 10-year forward income averaging. In addition, the portion of a lump sum attributable to contributions prior to January 1, 1974, may qualify for capital gains treatment.

Additional income tax on early withdrawals

Generally, under present law, a 10-percent additional income tax is imposed on withdrawals from an IRA before the owner of the IRA attains age 59½, dies, or becomes disabled.

Explanation of Provisions

Lump-sum distributions

The bill would repeal the 10-year averaging and capital gains treatment for lump-sum distributions from qualified plans.

Additional income tax on early withdrawals

Under the bill, the 10-percent additional income tax on withdrawals from an IRA by the owner prior to attainment of age 59½, death, or disability would be increased to 20 percent.

H. Coverage and Portability

1. Early distributions of benefits (secs. 141 and 251 of the bill, secs. 203 and 205 of ERISA, and secs. 411 and 417 of the Code)

Present Law

Under present law, in the case of an employee whose plan participation terminates, a pension plan may involuntarily "cash out" the benefit (i.e., pay out the balance to the credit of a plan participant without the participant's consent) if the present value of the benefit does not exceed $3,500. If a benefit is cashed-out under this rule, and the participant subsequently returns to employment and is covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which benefits were cashed out unless the employee "buys back" the benefit.

In addition, present law provides that, if the present value of an accrued benefit exceeds $3,500, then the benefit may not be immediately distributed without the consent of the participant (and, if applicable, the participant's spouse).

Present law provides that the present value of a qualified joint and survivor annuity may be immediately distributed if the value does not exceed $3,500. In addition, if the present value of a qualified joint and survivor annuity or a qualified preretirement survivor annuity exceeds $3,500, the plan may immediately distribute all or part of the present value of the annuity only if the participant and the participant's spouse (or the surviving spouse, if the participant has died) consents in writing to the distribution.

Under present law, the interest rate to be used in determining whether the present value of a benefit exceeds $3,500 may not be greater than the interest rate that would be used (as of the date of the distribution) by the Pension Benefit Guaranty Corporation (PBGC) for purposes of determining the present value of a lump sum distribution upon termination of the plan. The PBGC rate in effect at the beginning of a plan year may be used with respect to distributions made at any time during the plan year if the plan so provides.

Generally, a cash-out distribution from a qualified plan (whether voluntary or involuntary) may be rolled over, tax free, to an IRA or to another qualified plan if certain requirements are met.

Explanation of Provision

Under the bill, an accrued benefit would not be treated as nonforefeitable unless, in the case of any lump-sum distribution made before a participant attains age 59½, dies, or becomes disabled, the distribution is made in a direct transfer (after notice to the participant or the participant's beneficiary) to an individual retirement account or annuity (an IRA). The participant or the participant's beneficiary (if the participant has died) would be required to designate the IRA and to demonstrate to the satisfaction of the plan administrator that the account or annuity is willing to accept the transfer.

The bill provides that, if the participant or the participant's beneficiary fails to designate an IRA for receipt of an involuntary cash out within 60 days after the notice from the plan administrator, the plan administrator would be permitted to make a direct transfer to an IRA selected by the plan administrator.

In addition, the bill provides that similar rules would apply to the cash-out of benefits with respect to a qualified joint and survivor annuity and a qualified preretirement survivor annuity.

2. Special rules for simplified employee pensions (secs. 252-254 of the bill and sec. 408(k) of the Code)

Present Law

In general

Under present law, if an IRA qualifies as a simplified employee pension (SEP), the annual IRA deduction limit is increased to the lesser of $30,000 or 15 percent of compensation. The increased deduction limit applies only to employer contributions.

An IRA qualifies as a SEP for a calendar year if certain requirements relating to employee withdrawals and the employer contribution allocation formula are met. The allocation rules are designed to insure that employer contributions are made on a basis that does not discriminate in favor of employees who are officers, shareholders, or highly compensated.

Integration of SEP benefits with social security

Under present law, a SEP is not qualified unless the employer contributions are nondiscriminatory without taking into account the employer's contributions on behalf of employees to social security. However, if the employer does not maintain any other integrated plan, then the employer's contributions (OASDI contributions) on behalf of an employee to social security may be taken into account as contributions by the employer to the SEP, but only if such contributions are taken into account with respect to each employee maintaining a SEP.

Present law provides that an integrated plan is a plan that would not meet the qualification requirements if social security contributions were not taken into account.

Explanation of Provisions

In general

The bill would revise the qualification requirements relating to SEPs to permit employees to elect to have SEP contributions made on their behalf or to receive the contribution in cash. In addition, the bill would repeal the provision permitting SEP contributions to be integrated with social security and would apply a limitation on annual SEP contributions that is tied to the contribution and benefit base under the Social Security Act.

Salary reduction SEPs

Under the bill, employees who participate in a SEP would be permitted to elect to have contributions made to the SEP or to receive the contributions in cash. The election to have amounts contributed to a SEP or to receive the amounts in cash would be available only in a taxable year in which the employer maintaining the SEP has 25 or fewer employees as of the beginning of the taxable year. If an employee elects to have contributions made on the employee's behalf to the SEP, the contribution would not be treated as having been distributed or made available to the employee. In addition, the contribution would not be treated as an employee contribution merely because the SEP provides the employee with such an election. Therefore, under the bill, an employee would not be required to include in income currently the amounts an employee elects to have contributed to the SEP.

The bill provides that the election to have amounts contributed to a SEP or received in cash would be available only if at least 50 percent of the employees of the employer elect to have amounts contributed to the SEP. In addition, under the bill, the amount eligible to be deferred as a percentage of an owner-employee's compensation (i.e., the deferral percentage) would be limited by the average deferral percentage for all other employees who participate. The deferral percentage for each owner-employee cannot exceed the deferral percentage for all other participating employees by more than 150 percent.

For purposes of determining the deferral percentages, an employee's compensation would be the amount of the employee's compensation taken into account under the SEP for purposes of calculating the contribution that may be made on the employee's behalf for the year. Further, if an employee participates in more than one SEP of the employer, the employee's deferral percentage is the sum of the employee's deferral percentages under each of the SEPs.

In addition, the provision permitting employees to elect to defer compensation under a SEP would not apply unless the trustee of the SEP assumed the fiduciary duties imposed under ERISA.

Integration under SEPs

Under the bill, for purposes of testing whether the contributions or benefits under a SEP are nondiscriminatory, the contributions made by the employer on behalf of employees to Social Security could not be taken into account.

Wage-based contribution limitation for SEPs

Under the bill, the limit on compensation taken into account under SEPs would be revised to equal 500 percent of the contribution and benefit base in effect for the year under the Social Security Act, $210,000 in 1986.

I. Effective Dates

The bill generally would be effective with respect to any plan for plan years ending after the later of 2 years after the date of enactment of the bill or the earlier of (1) the effective date of the first plan amendment adopted after the date of enactment or (2) December 31, 1990. The provisions relating to individual retirement arrangements would be effective for taxable years ending after December 31, 1990.

A special effective date would be provided for collectively bargained plans. In the case of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers ratified before the date of enactment, the bill would be effective for plan years ending after the later of 2 years after the date of enactment or the earliest of (1) the date on which the last of the collective bargaining agreements relating to the plan terminated (determined without regard to any extension ratified after the date of enactment), (2) the effective date of the first plan amendment adopted after the date of enactment, or (3) December 31, 1990.

Senator **Heinz**. Good morning, ladies and gentlemen. This is a hearing of the Savings, Pensions, and Investment Policy Subcommittee of the Finance Committee. We welcome all of you and our witnesses. Our committee faces quite a challenge, namely the task of encouraging our voluntary system of employer-sponsored pensions to deliver substantial retirement benefits to a broad cross section of American workers.

Several decades from now, the average person may be living nearly as many retired years as working years. As a result, younger workers today have to earn their retirement benefits over a shorter period relative to the time that they will be dependent on the benefits they have earned.

Recognizing that this possibility lies ahead, we believe it is imperative to seek to improve the benefits actually paid to workers who will rely the most on employer-sponsored pensions for their retirement. For this reason, Senator Chafee and I have brought the Retirement Income Policy Act before the Finance Committee and are holding this hearing today.

I might add on behalf of Senator Chafee that he has been requested to come to the White House together with the Senate bipartisan leadership, and he will be unable to attend the hearing, in all likelihood, but he did ask me last night, as we were flying back from New York together about midnight, to extend his regrets that he would not be able to be here, and he is nonetheless deeply interested in this legislation.

Throughout the past year, we have worked with experts from business, labor, and the rest of the pension community to develop legislation to advance our common objective of improving retirement income. While this is principally a bill to expand coverage and improve the certainty of receiving pension benefits, it is also intended to contribute to what we believe is a long-overdue discussion of national retirement income policy.

This hearing today will be an important part of that discussion. We come to our task at a particularly difficult time. Shortly, this committee, the Finance Committee, will turn to the complex task of reforming the Internal Revenue Code to make it simpler and fairer. As much as I and many of my colleagues would prefer to review retirement income policy as a separate issue, separate from tax reform, we cannot ignore the substantial pressures that bear on the retirement system from the underlying thrust of virtually every tax-reform proposal.

There are, indeed, limits to the amounts that companies can spend on employee benefits. There are limits to the amount that individuals can realistically be expected to save for themselves. And now, apparently under tax reform, there are new limits on the amount of tax revenue that the Federal Government can forgo. So, in a climate of base-broadening, revenue-neutral tax reform, we must search for the most efficient ways to encourage capital formation, savings, and retirement income accumulation.

The Retirement Income Policy Act starts from the belief that long-term savings contributes most directly to capital formation and that employer-provided benefits yield the broadest delivery of benefits.

Voluntary savings is becoming an increasingly important supplement to employer-provided benefits, one that places at least some of the responsibility for retirement income on the individual. Voluntary savings can add a significant dimension in the retirement system, but it probably cannot achieve the broad participation and benefit delivery that is possible with employer-provided benefits.

While Senator Chafee and I are very much committed to encouraging and increasing accumulation of retirement savings, I am sensitive as well to the limited resources that can be dedicated to this activity. Some people have concern that there is an inordinate amount of tax expenditure committed to retirement savings, and second, that pensions overly benefit the affluent by providing inequitable opportunities for excessive sheltering from taxation.

I do not believe that we should fashion retirement income policy principally by focusing on the abuses. If there are abuses, we should address them, but it should not be the means of shaping, what is to be a broad long-term policy for retirement income. Instead, the emphasis should be on encouraging broad benefit delivery to the average worker.

The bill that Senator Chafee and I have introduced, S. 1784, was introduced with this concern in mind, and it is a pleasure to have the opportunity today to hear the views of a very distinguished group of witnesses, expert practitioners that are here to testify on the Retirement Income Policy Act.

Would the first panel of witnesses please come forward. That would be Howard C. Weizmann, L. Mark Rigg, Harry Garber, and Verle G. Whittington.

I am advised that, due to the fine weather between Philadelphia and Washington, DC, my constituent, Howard Weizmann, who testified at an earlier hearing of the Senate Special Committee on Aging, who is the Manager of Benefits Planning and Design at the Sun Co., from Radnor, will be delayed, due to inclement weather.

So, Mr. Rigg, Mr. Garber, and Mr. Whittington, welcome. We are delighted that you are here, and we thank you for your participation. Mr. Rigg, please identify yourself and proceed.

STATEMENT OF L. MARK RIGG, VICE PRESIDENT, HUMAN RESOURCES, THE SOUTHLAND CORP., DALLAS, TX

Mr. Rigg. Mr. Chairman and members of the Committee, my name is Mark Rigg. I am vice president of Human Resources for the Southland Corp., best known as the originator for the convenience store concept, an operator and franchisor of 7-Eleven stores across the United States. Southland is also a major processor of dairy products, operates Citgo petroleum and several other businesses.

In the interest of time, I am only going to highlight the major points which we are concerned with instead of rigorously following the prepared text.

Senator Heinz. May I add that, as you all know, so there is appropriate time for questions and discussion, and I will add the necessary time to compensate, witnesses were asked, and agreed, to limit their comments to 3 minutes. We have a lot of witnesses, and—I see some surprised looks.

Mr. HURD. Five.

Senator HEINZ. Five. [Laughter.]

We will compromise on four. [Laughter.]

All right. But we are going to have to be fairly rigorous, so I am going to gavel you down on the compromise, so talk fast, and we will let you start all over again, now that you have identified yourself. Thank you very much, Mr. Rigg.

Mr. RIGG. I am pleased to be here today on behalf of our company, and especially on behalf of 33,000 employees who participate in our profit-sharing plan.

Our plan was established in 1949 and has basically remained unchanged since then. The plan is voluntary. Participants contribute 6 percent of their compensation before taxes up to a maximum of $7,200. The company allocates its portion of contribution under a formula which considers both employee deferrals and years of service. It is the only retirement vehicle for Southland's employees. It has a successful record of providing employees with a means of saving for their own financial security in their retirement years.

Mr. Chairman, we agree with you that there is no common thread in our patchwork pension and defined contribution legislation today. We need to have a clearer sense of national policy with regard to retirement income. Retirement policy should foster the goals of enhancing personal retirement savings and encouraging companies to establish retirement plans, thus reducing the reliance on Government programs such as Social Security.

The Retirement Income Policy Act of 1985, Senate bill 1784, takes a positive approach toward accomplishing these goals. We applaud you for addressing these issues from a policy standpoint as opposed to merely looking at the short-term revenue impact, as was done by the House in title 11 of H.R. 3838.

There are two subjects I would like to discuss at this time. Annual limitations to retirement plans and preconditions for savings plans. We feel that with the changes we are recommending, your bill will be further strengthened and brought closer to accomplishing the policy objectives. The proposed section 415 limits may appear to be reasonable; however, the proposed annual limit is fair only if contributions are being made every year. Unfortunately, that is not always the case.

For example, if one company does well year in and year out, its employees will end up in a different, but better, position than the employees of a company that does well one year and not so well in another. In addition, for those companies with plans weighted toward years of service, the proposed annual limit may be unfair for individual participants who are nearing retirement and who are counting on a larger company contribution needed to fund their retirement.

What we suggest as a remedy to this problem is that the limits be on a cumulative basis. That is, apply the test on a cumulative basis to 20 percent of the employee's compensation while a participant in the plan, or 50 percent of the annual social security wage base, whichever is less.

By making this modification, employees who receive less in their early years could catch up in their later years. The cumulative limit would also be fairer to companies with fluctuating profits.

Second, in order for us to have a savings plan, Senate bill 1784 requires a 3-percent contribution to a retirement plan for each plan participant. We feel accessibility to savings is a key factor in encouraging employees to participate in profit sharing. In Canada, where a participant cannot get any money until retirement, as required by Canadian law, our participation rate is 50 percent. In the United States it is 82 percent, under basically the same plan.

In our plan, which requires a 6-percent contribution, there have been a few years where the company contribution would not have equaled 3 percent for those with less than 5 years of service. If the 3-percent rule only affected those with 5 years of service or more, we would not have any problems.

In conclusion, Mr. Chairman, we urge you to substitute Senate bill 1784 with the changes suggested today for title 11 of H.R. 3838.

If there are any questions, I'll be glad to try and answer them.

Senator HEINZ. Mr. Rigg, thank you very much. And I congratulate you on a very concise and helpful presentation. Mr. Garber.

[Mr. Rigg's prepared written statement follows:]

TESTIMONY OF MARK RIGG, VICE PRESIDENT, HUMAN RESOURCES, THE SOUTHLAND CORP.

Mr. Chairman and Members of the Committee, my name is Mark Rigg. I am Vice President of Human Resources for The Southland Corporation, best known as the originator for the convenience store concept and operator and franchisor of 7-Eleven stores across the U.S. Southland is also a major processor of dairy products and operates Citgo Petroleum, and other businesses.

In the interest of time I am only going to highlight the major points about which we are concerned instead of rigorously following the prepared text.

I am pleased to be here today on behalf of our company, and especially on behalf of 33,000 employees who participate in our Profit Sharing Plan. Our plan was established in 1949 and has remained basically unchanged since then.

The plan is voluntary. Participants contribute six percent of their compensation, before taxes, up to a maximum of $7,200. The company allocates its portion of contribution under a formula which considers both employee deferrals and years of service. It is the only retirement vehicle for Southland's employees. The plan has a long and successful record of providing employees with a means of saving for their own financial security in retirement years.

Mr. Chairman, we agree with you that there is no common thread in our patchwork pension and deferred contribution legislation today. We need to have a clear sense of national policy with regard to retirement income.

Retirement policy should foster the goals of enhancing personal retirement savings and encouraging companies to establish retirement plans, thus reducing the reliance on government programs such as Social Security to provide individual retirement needs. The Retirement Income Policy Act of 1985, S.1784, takes a positive approach toward accomplishing these goals.

We applaud you for addressing this issue from a policy standpoint as opposed to merely looking at the short-term revenue impact as was done by the House in Title XI of H.R. 3838.

There are two subjects I would like to discuss at this time -- annual limitations to retirement plans and pre-conditions for savings plans.

We feel that with the changes we are recommending, your bill will be further strengthened and brought closer to accomplishing the desired policy objectives.

The proposed Section 415 limits may appear to be reasonable; however, the proposed annual limit is fair only if contributions are being made every year. Unfortunately, that is not always the case. For example, if one company does well year-in and year-out, its employees will end up on a different, but better position, than the employees of a company that does well one year and not so well another.

In addition, for those companies with plans weighted toward years-of-service, the proposed annual limit may be unfair for individual participants who are nearing retirement and who are counting on a larger company contribution needed to fund their retirement.

What we suggest as a remedy to this problem is that the limits be on a cumulative basis. That is, apply the test on a cumulative basis to 20% of an employee's compensation while a participant in the plan, or 50% of the total of the annual social security base, whichever is less. By making this modification, employees who received less in their early years could catch up in their later years. This cumulative limit would also be fairer to companies with fluctuating profits.

The second point I would like to address is preconditions to having a saving plan. In order for us to have a savings plan S.1784 would require a 3% company contribution be made to a retirement plan for each plan participant every year.

Accessibility to savings is a key factor in encouraging employees to participate in profit sharing. In Canada where a participant cannot get any money until retirement as required by Canadian law, our participation rate is 50%; in the U.S. it is 82%.

In our plan, which requires a 6% contribution there have been a few years when the company contribution would not have equalled 3% for those with less than 5 years of service. If the 3% rule only affected those with 5 years of service or more we would not have any problems.

In conclusion, Mr. Chairman, we urge you to substitute S.1784 with the changes suggested today for Title XI of H.R. 3838.

If there are any questions I'll be glad to try and answer them.

Thank you.

STATEMENT OF HARRY GARBER, VICE CHAIRMAN, THE EQUITABLE, LONG ISLAND, NY

Mr. **Garber**. Thank you, Mr. Chairman. I am Harry Garber, the Vice Chairman of Equitable Life. Equitable is a mutual life insurance company which manages about $50 billion of pension assets on behalf of 2,000 large and medium sized employers and whole host of smaller employers. We are a substantial employer ourselves, and I will to look at S. 1784 from the point of view of both an employer and a plan sponsor.

Your Subcommittee and your House colleagues are to be congratulated for undertaking this important and difficult task at this particularly difficult time for voluntary pensions. Your efforts have really focused discussion and debate on the proper issues at this time, and that's a very important thing.

S. 1784 starts with a set of findings and a proposed set of national retirement income policy goals. Our experience would confirm most of the findings, and we would endorse wholeheartedly the proposed policy goals. In seeking to achieve these goals, the legislation appears to have three principal thrusts. One is to assure that all the funds accumulated for retirement purposes are used exclusively for those purposes. We'll call that the access issue.

To assure that virtually all employees of a retirement plan sponsor benefit to some degree from that plan and to expand substantially the growth of retirement income accumulation plans among employers who do not now provide such plans.

Equitable believes that the last thrust, expansion of coverage to new employers, should have priority. Our written statement documents our belief and concern that the proposed legislation will not, by itself, do much to foster and promote this expansion.

I won't summarize the main points of this statement because of the need to talk about the issues that you have to deal with in the next few weeks and months.

On the access issue, let me start by saying that we agree that retirement income accumulation should be used for retirement purposes. Our only concern is that legislation which mandates that result might severely inhibit the establishment of plans and/or the participation of employees. We would not oppose this legislative approach if we were comfortable that the question would be put back on the table if the extensions of retirement plans to new employees continues to lag and there is clear evidence that this mandated requirement is causing this lag.

The legislation proposes to extend benefits to additional employees of plans' sponsors through changes in coverage, integration, and vesting requirements. We agree that virtually all employees should benefit from an employer-financed pension plan. Our concern is whether the specific steps proposed will achieve the desired result without causing a significant number of plan terminations or an acceleration of the present trend away from defined benefit plans.

We believe that more information is needed on this subject, and we're sponsoring a study by a well-known public accounting firm to identify the issues, to analyze existing data, and to gather new data on employee circumstances and attitudes. This study is underway and should be completed by May. We will share the results with anyone who is interested.

401(k) arrangements have been very important in expanding employee retirement saving and as a pension plan vehicle for smaller employers. We applaud the recognition of the importance of this vehicle in the legislation. We have some concerns with the cutbacks that are proposed and how they might affect or restrict the growth of these plans. Our main concern is in the area of the dollar limitations, because——

Senator HEINZ. I'm sorry. What did you say? The main concern is what?

Mr. GARBER. Is in the area of the dollar limitations on savings, because this could inhibit both the extension of the plans to new employers and the growth in the rate of savings.

Quickly, two or three other points. The legislative changes, fundamentally the structure of the 415 limits, and we applaud the way in which this is now being structured; it's well conceived. We also applaud the time period given by plans to implement the proposed legislation. Thoughtful and welcome.

And if I could say one thing, finally, getting back to my first point, we are concerned——

Senator HEINZ. Who do you say nice things of. [Laughter.]

Mr. GARBER. OK. We're willing to be very reasonable. [Laughter.]

We are concerned with extensions of coverage. I have, in my testimony on the latter pages, pages 20 to 22, a proposal that the Federal Government consider—undertake a study of needs, retirement income needs, and undertake a campaign to communicate these needs to employers and employees. We think that such an effort would do much to foster and promote growth and would do so without being a high-cost item to the Treasury. Thank you very much.

Senator HEINZ. Mr. Garber, thank you very much for some very helpful insights and useful testimony.

Mr. Whittington.

[Mr. Garber's prepared written statement follows:]

STATEMENT BY
MR. HARRY GARBER, VICE CHAIRMAN OF
THE EQUITABLE LIFE ASSURANCE SOCIETY
OF THE UNITED STATES
ON
S.1784 -- THE RETIREMENT INCOME POLICY ACT OF 1985
TO
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
COMMITTEE ON FINANCE
UNITED STATES SENATE
JANUARY 28, 1986

Mr. Chairman and members of the Subcommittee:

I am Harry Garber, Vice Chairman of the Equitable Life Assurance Society of the United States. I am here today to testify on behalf of the Equitable with regard to the Retirement Income Policy Act of 1985, which is presently being considered by both Houses of Congress.

The Equitable is a mutual life insurance company. We and our subsidiaries manage more than fifty billion dollars in pension assets on behalf of over two thousand employers. The Equitable disburses annual retirement benefits to more than 285,000 pension annuitants. We and our subsidiaries are also employers of about 25,000 persons covering many professions and skills and engaged in many financial services businesses. I will seek to address the several issues in pension policy development from the viewpoints of a large employer and a provider of services to pension plan sponsors.

In my testimony I will seek first to provide some general backgound and to highlight current pension issues. I then plan to discuss the way in which the

Retirement Income Policy Act of 1985 (RIPA) addresses these issues and the likely impact of this legislation. Finally, I will offer some suggestions for additional approaches which might contribute toward achievement of national retirement income goals. The broad conclusions which I will suggest are (1) there is a clear need for a national retirement policy and for actions by the Federal government to permit attainment of these policy objectives, (2) RIPA starts the process by formulating policy goals but, in our view, the policy implementation steps proposed would do little to foster the attainment of these policy goals and (3) to attain the national retirement goals may require some new approaches. The final section of my testimony contains some suggestions in this respect.

I. BACKGROUND AND CURRENT ISSUES

For an individual, retirement planning is a very complex task, because it involves almost all of the uncertainties of life: future health, future family situation (in terms of support needs), future developments in the U.S. economy (particularly inflation), future employment prospects, age to which he or she will be able to work, income/asset accumulation provided by employer-sponsored pension plans, etc. But it is a task in which each of us must engage, and early in our working life if we are to achieve our retirement income goals. A few illustrations may help define the tasks. Assuming that assets set aside for retirement purposes accumulate for 30 years at a "real interest rate" of 3% on the average, it would be necessary to set aside $40 in 1986 to provide in 2016 for $100 of today's purchasing power. This means that a person would have to set aside an amount equal to 40% of his 1986 income to have an amount for the year 2016 which would provide the same purchasing power.

This is a rough measure of the task involved. It does not fully represent the amounts required to replace final pre-retirement income, however, because for most persons, income will grow at a rate slightly greater than the rate of inflation. If we assume that this excess amounts to 1% per year, a person would have to set aside, each year for the last 30 working years, an amount equal to almost 50% of his salary in order to provide, at age 65, a retirement income for 30 years equal in real terms to the salary in the year before retirement. If accumulations are delayed until the last 20 years of employment, the 50% figure rises to 80%. If the person works to age 70, but still saves only 30 or 20 years, the percentages drop to only about 45% and 70%, respectively. The 30 year retirement period is used because retirement asset accumulations should usually be based on the assumption that the person will outlive his life expectancy. More than 10% of men who retire at age 65 will still be alive at age 95. A person who is accumulating assets for his retirement assumes the risk of living beyond normal life expectancy, and must provide for the possibility that he will be among those that will live to age 95.

Of course, these figures do not reflect social security or the provisions under employer-sponsored pension plans, and the goal of fully replacing (in real terms) the income in the year before retirement is probably unnecessary and unrealistic except for low income levels. Even after adjustment for these considerations, the message is clear and compelling: retirement planning and provision requires significant asset accumulations and an early start.

Our national retirement income policy is usually described as a "three-legged stool", the three legs being social security, employer-sponsored pension plans and individual savings. This is a durable concept and one on which future plans and programs must be based. Today's issues arise not from any questioning of the concept of the "three-legged stool" but rather from the impact of several important social and economic developments on the existing programs, assumptions, goals and incentives in the area of retirement income. The most important of these issues are described briefly below.

- Size and Nature of Federal Government Incentives to Private Pension Arrangements - At one time there was an "unlimited budget" for the "tax expenditures" for employer-sponsored pension plans as long as the plans met broad requirements for the distribution of coverage and benefits. With the rapid growth of 401(k) plans and IRAs and the ongoing Federal budget concerns, however, this is no longer the case and this area has come under close scrutiny. In fact, most of the recent legislative activity seems to involve reduction in these so-called tax expenditures in order to reduce the deficit or to finance some other tax action. The relevant question no longer seems to be "What type of tax incentive could we introduce to further the growth of retirement accumulations?" but rather "How much should we reduce existing pension-related incentives?" or "How can we produce the greatest benefit for this tax expenditure?" In this environment, the examination of national retirement income goals and the development of actions to encourage the achievement of those goals appears to be adversely and unnecessarily constrained by the Federal government's budget deficit.

- Growth in Private Pensions/Extent of Coverage - It seems clear that there has been a pause in the growth record of employer-sponsored pensions plans when measured in terms of the percentage of employed persons covered by such arrangements. Examination of the available data indicates that the coverage shortfalls occur mostly with respect to smaller employers. But it is claimed by some that there are also coverage inadequacies through the operation of plan provisions in the areas of vesting, integration and in exclusions from coverage of employees in specific business units of a company. Plan sponsors would argue vigorously that many of the latter do not represent coverage inadequacies. Regardless of how this particular issue is resolved, it is clear that issues to be addressed in any national retirement policy include (1) how to achieve large coverage expansions among small employers and (2) consideration of the extent to which changes are required in the vesting, integration and anti-discrimination rules. Both of these issues are, of course, closely related to the question of what the size of the tax expenditure for private pension plans should be and to whom and under what circumstances it should be available. In fact, any substantial growth in pension coverage (either in numbers of persons covered or in benefits) will increase the strain on the federal budget. Although it is critical that pension policy be recognized as a national priority that has budget implications, it is very important that the issue receive a high level of support.

- Employer/Employee Attitudes - The third issue is the recognition of changing employer and employee attitudes in the area of retirement income. There is a growing concern on the part of employers with the uncertain future costs of final salary defined benefit plans which seek to guarantee a benefit, particularly plans which adjust benefit payments for inflation. Mortality improvements, high inflation rates, unstable financial markets, increased competition, stricter pension plan accounting rules and other factors have increased the attractiveness of the fixed and determinable costs of defined contribution plans. The changes required in defined benefit plans in recent years, particularly the reduction in the 415 limits, has further eroded support for the defined benefit approach. At issue is the degree to which additional changes and restrictions can be mandated in these plans without causing a massive movement away from this desirable type of plan.

On the employee side, there is increased employee mobility, an increasing number of two-income families and an increasing financial sophistication, including increased awareness of and interest in tax-favored accumulations. 401(k)s are a great success story. A world in which employees have a greater voice in and greater control over retirement savings is a social element which should be recognized in any national retirement policy. Note in this respect that the growth of the employee desire to increase responsibility for retirement savings and the employer's desire to reduce risk and unknown costs are complementary and ease the formulation of policy goals.

II. SPECIFIC COMMENTS ON THE PROPOSED RETIREMENT INCOME POLICY ACT

Section 2 of the proposed policy act presents (i) findings and conclusions and (ii) national income retirement goals. We wholeheartedly endorse the national retirement policy goals with one minor reservation. That reservation concerns the distinction drawn in the goals and in the implementing legislation between employer-sponsored savings plans, on the one hand, and employer-sponsored retirement plans on the other. As my subsequent comments will indicate, we are not certain that this is a useful or appropriate distinction in an overall effort to increase retirement income coverage and benefits. This is a reservation in what is otherwise an enthusiastic endorsement of the proposed goals.

In essence, the national retirement income goals seek voluntary universal coverage of employees and increased benefits for those covered in order to approximate more closely "replacement" of pre-retirement income levels. The fundamental standard against which the implementing legislation must be measured is the degree to which it will cause a substantial advance towards the policy goals. We do not believe the implementing legislation will help much in the attainment of these goals and may, in fact, cause some regression.

The following are more detailed comments on the specific changes proposed in RIPA.

PROPOSAL FOR DUAL RETIREMENT PLAN SYSTEM

RIPA attempts to encourage the formation of retirement plans in part by creating a dichotomy between what it terms "retirement income plans" and "nonretirement savings plans". Retirement income plans are viewed as providing the desired retirement income stream for employees during their retirement years. Nonretirement savings plans (which would encompass most defined contribution plans, including 401(k) plans as they are presently structured) are seen as providing a vehicle for capital accumulation by workers, as opposed to providing a steady income stream during the employee's retirement years.

The Equitable does not view the world of retirement savings as being so black and white. While we agree that encouraging the growth of plans that provide income during an employee's retirement years is a worthy goal, we believe it is a mistake to assume that merely because a plan permits distributions prior to a certain age or in a form other than a series of level periodic payments it will not provide a substantial contribution to meeting retirement income needs.

Although the present structure of most defined contribution plans would result in their being categorized as nonretirement savings plans under RIPA's retirement plan dichotomy, most defined contribution plans in fact currently serve as a legitimate source of retirement income for employees. Although many defined contribution plans contain loan and withdrawal provisions, our experience is that most employees covered by these plans have substantial accumulated benefits in the plan when they retire. Although the current distribution rules for defined contribution plans are less restrictive than those governing defined benefit plans (e.g., allowing pre-retirement withdrawals, lump sum distributions) few employees squander such distributions. The fact that an employee may use a defined contribution distribution to purchase a retirement home does not mean that he is not providing for his retirement needs -- a retirement home simply represents a different form of retirement security.

In order to encourage voluntary savings, however, not only must an employee perceive an important need, i.e., an accumulated fund for retirement, and have financial incentives, but he must be assured that he will have access to his savings in times of need. The ability to withdraw funds in case of hardship is an especially important concern of lower paid employees who, unlike higher paid employees, are unlikely to have other sources of income to draw upon in times of crisis. The repeal of present hardship withdrawal provisions may serve to discourage rather than encourage RIPA's goal of broadening the coverage to lower paid workers. Even with existing withdrawal provisions, many employees in defined contribution plans that permit withdrawals will leave their money in the plan until retirement. Although the effect of a hardship withdrawal provision is more psychological than real, employees will have some reluctance to contribute to a retirement plan if they believe that they cannot reach their money in an emergency. Our judgment, therefore, is that these provisions are an important element in fostering the continued growth in voluntary savings and that the importance for this purpose outweighs the costs of any potential misuses.

PROPOSED COVERAGE CHANGES

One of RIPA's goals is to expand present employee coverage - to provide more benefits to more people. RIPA attempts to do this by replacing the present non-discrimination tests (e.g., 70/80 and fair cross section tests) with a mechanical "relevant work force" test. Under this test, if an employer maintains a retirement income plan, he must cover 100% of his relevant work force whose salary falls below the Social Security wage base. There is a reduced coverage requirement (to 80%) if the employer maintains two or more "allowable subdivisions" (distinguished solely on the basis of distinct locality or product line). Although the imposition of this test is intended to produce broader coverage of an employer's work force, it may actually have the effect of discouraging an employer from establishing a plan, or worse yet, causing an employer who already maintains a plan to terminate it.

For example, suppose a company consists of two divisions, one of which is profitable and one of which is not. Under the bill, if an employer wants to establish a plan for the profitable division, he is forced to establish one for the unprofitable division as well. Small or midsize companies that cannot support pension costs for unprofitable divisions may well choose the least expensive alternative, and thereby provide no plan at all. Similarly, an equally undesirable outcome could occur if a company that does not sponsor a

CONCLUSION

Mr. Chairman, on behalf of all of the Federal Public and Community Defenders in the United States, we thank you once again for the opportunity to present our views on these proposed amendments and to answer questions of members of the Subcommittee and staff. Please feel free to call upon us at any time if we may be of assistance in connection with this or any other federal criminal justice legislation.

Mr. **Kastenmeier**. Thank you very much, Mr. Dahlin.

Ms. Leadbetter.

Ms. **Leadbetter**. Thank you, Mr. Chairman.

I also want to express my appreciation for being allowed to be here and state my views.

Since my written statement has already been made part of the record, I certainly won't read it. In addition, I think the views expressed by Judge MacBride in many respects overlapped the points that I was making. I will simply highlight a few points from my written testimony.

As you have stated, in my background I have seen this from both sides of the fence and, I would add, really from all three sides. I have acted as a prosecutor. I have served 3 years as a member of the Criminal Justice Act panel in our district. And I am currently not on the panel but serving on the court's Criminal Justice Act selection committee. So, I have seen the effect of the 1984 revisions in compensation in terms of the greatly increased quality of applicants to become members of the Criminal Justice Act panel.

If there are any questions in your minds about whether the 1984 revisions, which doubled the compensation rates, would have any effect on the quality of attorneys who want to be on the panel, I can tell you that in the Eastern District of Pennsylvania it has been dramatic. We were virtually flooded with persons asking to be put on the panel who were extremely well qualified this year. We had to reject some applications by qualified counsel because we had more than would ever be appointed. Under the guidelines submitted by our court in terms of how many people we could put on the panel, there were some people who were competent attorneys that we just had to say no to because we had so many really outstanding candidates.

I believe there are several very important points of this legislation. As I stated in my written testimony, I think that it is a very salutary change to go from a system which overcompensates or more greatly compensates courtroom activity to one which provides for equal pay for out-of-court work and in-court work. I know, I have been a trial lawyer for almost 15 years, and I know that there is not a trial lawyer alive who doesn't have a gigantic ego and who doesn't believe that it is his or her fancy footwork in the courtroom and brilliance in speaking to the jury that wins or loses cases. But in our hearts we all know that that is a lot of baloney. It is the hard work you do before you go into that courtroom that wins or loses cases and not how clever you are on the spot.

Federal prosecutions today are not simple cases. They tend to be complex cases. They tend to involve a lot of documents. And you can't do that on extemporaneous brilliance. You have to know the case cold before you walk in there. You have to look at the documents. You have to analyze them. You have to think about them. You have to know your theories. You have to know what questions are going to be asked of those witnesses. Sometimes you have to review hundreds of transcripts of tape recordings. You have to be prepared or you're lost.

their eclipse or demise. In the search for revenues to reduce the budget deficit, 401(k) plans are being eyed as a possible revenue-enhancement source. Reduction in the attractiveness of 401(k) plans is a short-sighted step for a nation already short of retirement savings.

RIPA proposes to change 401(k) plans in the following respects: (1) categorizing 401(k) plans as retirement income plans, thereby requiring such plans to comply with distribution requirements imposed upon retirement income plans (e.g., no lump sum distributions prior to age 59-1/2); (2) reduction of the cap on contributions to 401(k) plans from $30,000 to 25% of the Social Security wage base (currently $10,500); (3) repeal of the hardship withdrawal provisions; and (4) repeal of the ten year forward averaging treatment for lump sum distributions.

Requiring 401(k) plans to meet the restrictive retirement income distribution requirements could serve as a disincentive for adoption of such plans. These requirements, coupled with the repeal of the hardship withdrawal and ten year forward averaging provisions (as discussed below), could negate the tax and other incentives for employees who want to voluntarily save for retirement but who don't want to lock their money away in case of crisis.

Traditional defined benefit plans (the model of a retirement income plan) are substantively and administratively costly - much more so than the traditional defined contribution plan (e.g., 401(k)). Lower contribution limits, together with more restrictive distribution and withdrawal rules will serve to discourage employers from establishing retirement plans for their employees. We are certain RIPA's drafters did not intend this result.

A small or midsize employer (those employers that RIPA is especially targeted towards) will only adopt a retirement plan if the value to the business is worth the cost. A critical factor is the degree to which the plan would permit the employer to attract and retain key executives, management, sales, and technical employees. In this regard, we note that both RIPA and the Tax Reform Act significantly reduce the cap on contributions that may be made to a 401(k) plan. Although RIPA's 401(k) limit is higher than the one contained in the Tax Reform Act (25% of the Social Security base, approximately $10,500, compared to $7,000) it is still significantly lower than the present law's $30,000 cap. Lowering the present law cap won't help the process of expanding coverage and benefits among small and medium-sized employers. The current 401(k) discrimination test is designed to ensure that 401(k) plans do not inordinately benefit an employer's highly compensated employees without providing substantial benefits for his lower paid employees. Employer matching contributions help ensure that this discrimination test is met. Because the discrimination rules ensure fair treatment of employees at all income levels, a massive reduction in the contribution limits as a part of a legislative package designed to achieve increased retirement coverage and benefits and to foster individual savings makes little sense.

As mentioned earlier, we believe the 401(k) hardship withdrawal provisions should be retained. In this regard, we note that the Tax Reform Act retains the hardship withdrawal provisions of present law.

RIPA also repeals the ten year forward averaging tax treatment for lump sum distributions from retirement plans, including 401(k) plans. We are

TESTIMONY OF BONNIE BRIGANCE LEADBETTER, ESQUIRE
REPRESENTING THE NATIONAL LEGAL AID AND DEFENDER ASSOCIATION
ON THE CRIMINAL JUSTICE ACT REVISIONS OF 1985, H.R.
BEFORE THE SUBCOMMITTEE ON COURTS, CIVIL LIBERTIES AND THE ADMINISTRATION OF JUSTICE OF THE COMMITTEE ON THE JUDICIARY, UNITED STATES HOUSE OF REPRESENTATIVES

July 25, 1985

Good Morning Mr. Chairman:

I am pleased to be here today representing the National Legal Aid and Defender Association in support of House Bill No. _______, the Criminal Justice Act Revisions of 1985. I think a number of the proposed revisions in this bill deserve comment.

One of the significant changes in this legislation would be to eliminate the discrepancy between compensation for time spent in court and time spent out of court. This is a salutary change which largely brings the Criminal Justice Act framework into conformity with current standards in the practice of law. Few private attorneys maintain such a distinction for their hourly rate clients and modern trends toward efficiency in litigation have systematically cut back on unnecessary courtroom time once considered de rigueur (e.g., submission of pure legal issues on briefs in favor of oral argument, status and scheduling discussions by telephone conference call, etc.) Most important, it encourages (by more justly compensating) careful pretrial preparation. Thorough preparation results not only in a better defense for the accused (or other represented individual) but also serves the overall administration of justice in a number of ways. If the government's case is strong and defense counsel has a thorough understanding of that case, guilty pleas are more likely. Even in cases where a trial is necessary, thorough preparation can often yield stipulations concerning issues which are not in dispute and would be time consuming to present in the manner required by the rules of evidence. In cases involving complex and extensive documents, well encouraging an equitable distribution of benefits under qualified plans. RIPA's new Social Security integration rules appear to be aimed at improved benefit delivery for lower paid employees. It is not clear that this specific RIPA proposal is the best method to accomplish this objective. In the past, integration rules have been the subject of considerable controversy revolving mainly around fairness issues. Whatever approach is taken, it should be sufficiently flexible to ensure that changes enacted accomplish their intended purpose. We should know what the impact will be before the changes are made.

DELAYED EFFECTIVE DATES

During the past few years the enactment of numerous pieces of legislation, each attempting to remedy perceived abuses in the private pension system, have brought a great deal of disruption in the pension community. The result of these piecemeal reform attempts has been to create much confusion and expense for employers who maintain plans. The accompanying attachments detail the pension legislation that has emerged since 1974, as well as the typical expenses involved in the plan amendment process. The attachments illustrate the problems that have emerged as a result of piecemeal legislation over the past decade.

RIPA acknowledges that, with regard to pension legislation, we have had too much too fast. It does this by having delayed effective dates for implementation of the final legislative provisions. This makes much sense in these circumstances.

COMPREHENSIVE PENSION LEGISLATION

The consideration of national pension policy should be done in a single piece of legislation that is analyzed in a pension policy forum. Congress presently has before it numerous proposals for pension legislation (e.g., RIPA, the Tax Reform Act of 1985, the Budget Reconciliation bill), each of which addresses various aspects of the private pension system. In many respects the substantive provisions of these bills are overlapping. The Tax Reform Act and RIPA in particular revise many of the same ERISA and Internal Revenue Code provisions. The changes which would be made by these bills to ERISA and the Code are often inconsistent. Changes in the private pension system in accordance with a national retirement income policy can be achieved only with great difficulty if each part of the system is addressed in a different piece of legislation. If changes in our pension laws are contemplated they should be addressed in the proper forum and accomplished through comprehensive, unitary legislation. Therefore, the Equitable supports the consideration of pension policy issues in the context of an overall review of retirement income policy. RIPA attempts to do this by considering the issue of expanding plan formation and growth in the proper context.

The Tax Reform Act addresses itself to revising the federal tax system but the provisions are largely revenue driven. Revenue raising, by its very nature, is inconsistent with the goal of encouraging plan formation and growth which is largely driven by tax incentives. Therefore, the consideration of pension policy should be segregated from the subject of tax reform.

limits should cover simple felony cases, but will still require approval in even moderately complex cases. While experience suggests that compensation in excess of the ceiling will be granted by the Court when appropriate, it makes no sense for CJA attorneys to be required to write memos justifying excess compensation in virtually all cases, nor to require the Chief Judges of our Circuits - already overburdened with caseloads and administrative responsibilities - to read them. The proposed changes strike an appropriate balance.

Perhaps the most important proposed change is the increased limit for investigative, expert and other services. As an Assistant United States Attorney, I was accustomed to having a wealth of litigation support services at my fingertips. The cost of such services - and learning to do without because of most clients' inability to afford them - was one of the greatest changes in my transition to private practice. Most of these services fall into three basic categories: 1) the work of private investigators; 2) testing, evaluation and testimony by experts; and 3) preparation of analytical and demonstrative aids and evidence, such as computerization of records, transcription of tape recordings, and preparation of charts, graphs, photographs and blowups. Even the most nominal of such services cannot be obtained for under $150 and the present limit of $300 will pay for only the simplest investigative task or demonstrative aid. It will not begin to pay for a psychiatric evaluation, let alone any expert testimony in court. Such services are certainly not necessary in every case, but when they are needed, they are indispensable. Moreover, appropriately utilized, litigation support services allow the CJA attorney to use his time more efficiently with concurrent savings in counsel fees.. The proposed limits of $300 without prior approval and $1,000 when pre-approved by the Court provide a realistic level of support for the court appointed attorney with appropriate safeguards against unnecessary spending.

For these reasons, I urge passage of the proposed amendments.

My second suggestion builds on the first. I believe that, in most cases, a strong motivation for retirement savings stems from the necessity each person perceives to provide for his or her retirement years. Although the tax incentives permit the saving of larger sums than would otherwise be the case, they are not the only reason for retirement savings. Similarly, the motivation for employers to establish pension plans is in part to ensure that employees will have adequate retirement accumulation, although, obviously, it is necessary that the cost to the employer of such pension plans be commensurate with the perceived value to the employees.

Given the very large amounts which must be accumulated to permit income maintenance in retirement years, it is important that these natural tendencies be reinforced and supported by communication. I would suggest, therefore, that as a major element in the implementation of the national retirement income goals, an agency of the federal government undertake a continuing educational and communications program designed to help individuals understand the need for retirement planning and the place of each of the various sources of retirement savings and accumulation in that individual's retirement plan. The communications program should also seek to motivate individuals to regularly review their total retirement program (including expected social security benefits and benefits or accumulations from employer-financed plans) in terms of their individual retirement income goals. This communications program should also be directed at employers, with particular emphasis on the general levels of employer contributions needed for the attainment of the national retirement income goals. The purpose of this overall effort would be to increase retirement income accumulations by focusing on the individual needs and goals and on the specific actions to meet these goals. An example of how well a good communications program can work is the experience with IRAs. IRAs are a great success story in illustrating that through the use of communication, advertising, and promotion, the private sector is able to encourage many people to save for retirement. We believe that this same philosophy could work in a broader application.

Finally, I would like to discuss briefly the broad question of how tax incentives should be structured for the retirement income accumulations program.

Under present law (with the exception of 401(k) plans), full incentives are available as long as the pension plan meets the specified minimum requirements. These requirements cover, among other things, integration, vesting, and coverage. These are "cliff-type" requirements. As long as the plan meets the specified detailed requirements the full set of incentives are available; none are available if the plan fails to meet these requirements. Under a 401(k) plan, the discrimination requirements are stated in terms of a comparison of the average benefits (expressed as a percentage of income) of high paid employees as compared with the corresponding average benefits of low paid employees. This type of structure is flexible - it can be molded to fit individual company circumstances and, best of all, provides incentives to increased benefits for both low paid and high paid employees. As a substitute in full or, in part, for the present structure of specified, detailed, minimum

Mr. **Kastenmeier**. It is the only thing—and I say this certainly not out of experience but just to draw out your conclusion. Are you speaking of all habeas corpus cases or some habeas corpus cases? The point I am making is that some are considered rather routine. That is to say, they are essentially, at least in the crudest form, sort of just a restatement of something, frankly, already advanced, even though they are supposed to be somewhat different.

I guess my point is, would all habeas corpus cases be as complex and as difficult and time consuming for a counsel as one that you just described?

Ms. **Leadbetter**. Yes, they would be. Certainly many of them turn out to be meritless, but an attorney cannot assess the fact that they are meritless until after he has read the transcript of the trial and possibly done some legal research.

Often direct appeals are totally meritless but are taken because the defendant thinks he has nothing to lose and in fact does have nothing to lose and strongly wants to press an appeal. That doesn't mean the lawyer doesn't have to do the work to present the best case to the court. In fact, sometimes when you have to search for an issue to present, you have to do more work than when the issues are self-evident.

I think that the analogy to a direct appeal is a pretty good analogy. Certainly, many are meritless but the amount of work and the kinds of review that the lawyer has to do are very similar.

Mr. **Kastenmeier**. And you would say that that is the case irrespective of the fact that it is conceivable there could be some reform in habeas corpus coming along at some point?

Ms. **Leadbetter**. Well, I guess that would depend on what the reform would be. Certainly there is no reason that an attorney must go to the ceiling in every case. In many cases they do not.

Mr. **Kastenmeier**. Mr. Dahlin, do you have any comment either on the preceding testimony or on H.R. 3004?

Mr. **Dahlin**. I would second Ms. Leadbetter's comments.

I would address one point, something that is not addressed in the bill but refers to Congressman Berman's comment. That is the question of pay for the Federal defender. I am not talking about deputies or assistants.

The current wording is that compensation of the Federal Public Defender cannot exceed that of the U.S. attorney but there is no statutory provision for parity. The argument that Judge MacBride mentioned that is usually cited is that the U.S. attorney's office is larger in terms of people. They may have a lands division and a civil division, a forfeiture division, et cetera. It seems to me that the emphasis on that point—and again this is not addressed in these amendments. But the emphasis there should be that the Federal defender in an adversary system has a comparable responsibility to the U.S. attorney in the significance of his role in the adversary system.

Mr. **Kastenmeier**. As one engaged in prosecution, you agree that prosecutors are not in a good or as good a position to certify defense witnesses as, say, public defenders or other defense attorneys?

Mr. **Dahlin**. I think that ought to be up to the Federal defender, clearly. There can be a conflict. We certainly have experienced in our district, not so much currently but certainly in the past, that the assistant U.S. attorney on the case, may resent the fact that you have done an effective job or may be smarting, for whatever reasons, and will drag his feet. And that is inappropriate. I think witnesses, they are witnesses of the court, really, they are appearing before the court and should be treated courteously and with dispatch. And I think that is more likely to happen if the Federal defender has that authority.

Mr. **KASTENMEIER**. On behalf of the committee, I want to thank you both, Ms. Leadbetter and Mr. Dahlin, for your very helpful testimony this morning.

Obviously, as a sponsor of this bill, I am hopeful that the committee can move it forward. We will take your own expert testimony in support of it as a major aid in achieving that result. Thank you very much.

This concludes the hearing this morning. The committee stands adjourned until next Monday at 2 o'clock.

[Whereupon, at 11:50 a.m., the subcommittee was adjourned.]

A small employer has an alternative; he can adopt a master or prototype plan sponsored by a financial institution. The plan's sponsor, not the employer, is responsible for amending such a plan. However, in the last few years, the constant stream of required amendments have become costly enough to threaten the viability of master and prototype plans.

To look at one example, Equitable amended a master plan early in 1984 to conform with tne changes enacted in the Tàx Equity and Fiscal Responsibility Act of 1982. Here's what happened:

January 1984	Plan amended to comply with TEFRA
March 19, 1984	IRS publishes sample language; plan amended again
June 18, 1984	Plan filed on first day IRS is accepting applications
July 18, 1984	Enactment of Deficit Reduction Act
August 23, 1984	Enactment of Retirement Equity Act
November 14, 1984	Comments received from IRS
December 12, 1984	Meeting with IRS; proposed amendements complying with DEFRA and REA filed with IRS
December 18, 1984	Meeting with IRS
December 31, 1984	Amendments filed with IRS

March 7, 1985	Additional comments received from IRS
May 17, 1985	Amendments filed with IRS
June 1985	New IRS reviewer assigned to plan; oral comments received
July 24, 1985	Additional comments received from IRS
September 11, 1985	Amendments filed with IRS
November 1985	Oral comments received from IRS
December 2, 1985	Amendments filed with IRS
December 23, 1985	IRS approval letter issued

During this time, Equitable had to communicate several times with thousands of employers to let them know how their plans should be administered. Each such communication costs Equitable several thousand dollars. This same process must be repeated for each of our 11 master and prototype plans.

Other financial institutions are in the same situation. As a result, several major financial institutions are planning to stop offering master and prototype plans. The reason they cite is the expense of constantly amending their plans. If this expense continues to rise, this inexpensive alternative will no longer be available to the small employer.

"(I) faces loss of liberty in a case, and Federal law requires the appointment of counsel.

"(2) Whenever the United States magistrate or the court determines that the interests of justice so require, representation may be provided for any financially eligible person who—

"(A) is charged with a petty offense for which a sentence to confinement is authorized; or

"(B) is seeking relief under section 2241, 2254, or 2255 of title 28.

"(3) Private attorneys shall be appointed in a substantial proportion of the cases. Each plan may include, in addition to the provisions for private attorneys, either of the following or both:

"(A) Attorneys furnished by a bar association or a legal aid agency.

"(B) Attorneys furnished by a defender organization established in accordance with the provisions of subsection (g).".

(2) Subsection (b) is amended—

(A) in the second sentence—

(i) by striking out "In every criminal case" and all that follows through "violation of probation and" and inserting in lieu thereof "In every case in which a person entitled to representation under a plan approved under subsection (a)"; and

(ii) by striking out "defendant"; and inserting in lieu thereof "person";

(B) in the third sentence by striking out "defendant" each place it appears and inserting in lieu thereof "person"; and

(C) in the fifth sentence by striking out "defendants" and inserting in lieu thereof "persons".

(3)(A) Subsection (d)(1) is amended by striking out "not exceeding $60" and all that follows through "Such attorney" and inserting in lieu thereof the following: "not in excess of $50 per hour, unless the Judicial Conference determines that a higher rate of not in excess of $75 per hour is justified for a circuit or for particular districts within a circuit, for time expended in court or before a United States magistrate and for time expended out of court. The Judicial Conference may develop guidelines for determining the maximum hourly rates for each circuit in accordance with the preceding sentence, with variations by district, where appropriate, taking into account such factors as the minimum range of the prevailing hourly rates for qualified attorneys in the district in which the representation is provided and the recommendations of the judi-

STATEMENT OF VERLE G. WHITTINGTON, VICE PRESIDENT FOR EMPLOYEE RELATIONS, SHELL OIL CO., HOUSTON, TX

Mr. WHITTINGTON. I'm Verle Whittington, vice president of Employee Relations for Shell Oil Co. I appreciate this opportunity to be able to comment.

While we have some serious problems with the bill's impact on existing accumulations of pension and savings plans, if we were starting a new employee retirement program today, this bill has advantages over the retirement policy changes of the House tax reform bill. We think the Senate bill has more pluses than the House bill and fewer minuses. Long term, this bill is better for our employees than the House bill.

But we are concerned about one part of the bill in particular. That is the tax consequences this bill would have on qualified savings plans that have been in existence for many, many years. To comment on this, I will describe my company's plan and the devastating effects on employees that would result.

Since the 1930's, our retirement program has been a balanced one, with a foundation pension plan that provides monthly income; a retirement savings plan that provides capital and, of course, social security. Our pension plan began in 1938. It has always been company-paid. It pays a monthly income. Lump-sum distributions at retirement are not permitted. Thus, monthly income continues for life for the employees.

Our retirement savings plan began in 1939. It has encouraged employees to save, after tax dollars, by company matching, dollar-for-dollar, up to 10 percent of pay. The plan does not permit employees to withdraw pre-tax amounts until retirement, or until age 59½. Since these withdrawals are not permitted, employees accumulate large sums over 30 to 40 years of service. It's quite common for craftsmen, plant operators, secretaries, lower-level supervisory employees to receive lump-sum distributions when they retire of $150,000 to $225,000. Last year, about two-thirds of our retirements were in this category.

Since this bill would eliminate 10-year averaging and capital gains treatment and would tax all lump-sum distributions as ordinary income, if adopted, the tax for the typical retiring Shell employee would almost triple.

Under the House bill, the consequences would be even more severe for those retiring before age 59½. And 35 percent of our retirements last year were under 59½.

Employees, we think, have had every reason to believe that their distributions would be taxed at capital gain rates and 10 year averaging. These were the rules that existed when contributions were made. And they believe that if the rules were changed, as they have been in the past, the new rules would apply only to future accumulations. We think employees are entitled to retain the tax treatment that prompted their savings.

Furthermore, a retroactive tax increase on past accumulations represents a dangerous precedent. In the event Congress eliminates the current tax treatment of lump-sum distributions, it is absolutely essential to grandfather prior accruals. A grandfather rule has been used in previous lump-sum rule changes, in the Tax Reform

Act of 1969 and the ERISA of 1974. This would retain the existing tax treatment that employees expected and avoid retroactive taxation of "bunched" income.

Beyond this essential item, we continue to think that 10-year averaging is sound, that 401(k) plans, and PAYSOPS and ESOPS are important, but also that lower limits on contributions to retirement plans and restrictions on the distribution of savings plans will reduce the incentive for employees to save.

Thank you very much.

Senator HEINZ. Mr. Whittington, thank you very much.

[Mr. Whittington's prepared written statement follows:]

ment for such services after they have been obtained, even if the cost of such services exceeds $300.".

(C) Subsection (e)(3) is amended by striking out "$300" and inserting in lieu thereof "$1,000".

(5)(A) Subsection (h)(2)(A) is amended by striking out ", similarly as under title 28, United States Code, section 605, and subject to the conditions of that section" and inserting in lieu thereof "in accordance with section 605 of title 28".

(B) Subsection (h)(2)(B) is amended in the third sentence by striking out "coming" and inserting in lieu thereof "next fiscal".

(C) Subsection (h) is amended by adding at the end the following:

"(3) MALPRACTICE AND NEGLIGENCE SUITS.—The Director of the Administrative Office of the United States Courts shall, to the extent the Director considers appropriate, provide representation for and hold harmless, or provide liability insurance for, any person who is an officer or employee of either a Federal Public Defender Organization, or a Community Defender Organization receiving periodic sustaining grants, which is established under this subsection, for money damages for injury, loss of liberty, loss of property, or personal injury or death arising from malpractice or negligence of any such officer or employee in furnishing representational services under this section while acting within the scope of that person's office or employment.".

(6) Subsection (j) is amended by inserting immediately before the period at the end of the first sentence the following: ", including funds for the continuing education and training of persons providing representational services under this section".

(7) Subsection (l) is amended—

(A) by striking out ", other than subsection (h) of section 1,"; and

(B) by striking out "Act" each place it appears and inserting in lieu thereof "section".

(b) TECHNICAL AMENDMENTS.—

(1) Section 3006A of title 18, United States Code, is amended by striking out subsection (g) and redesignating subsections (h) through (l) as subsections (g) through (k), respectively.

(2) Subsection (j) of section 3006A of such title, as redesignated by paragraph (1), is amended to read as follows:

"(j) DISTRICTS INCLUDED.—As used in this section, the term 'district court' means each district court of the United States created by chapter 5 of title 28, the District be to reduce the amounts employees are willing to save for retirement. It would be particularly discouraging for younger employees and those who may not have sufficient other savings to provide for an emergency.

In order to demonstrate the effects of certain provisions, I would like to outline the major components of Shell's retirement program. Then, because it is so important, I will concentrate my comments in this statement on the changes in the treatment of distributions from savings plans which would be reclassified as "non-retirement savings plans."

Shell Retirement Program

Shell has attempted to provide its employees with a balanced retirement program which provides for the many needs employees face at that time in their lives. For years, this has included a pension plan, a supplemental retirement savings plan, and, of course, Social Security. We also have an Employee Stock Ownership Plan and recently we added a 401(k) plan.

1. Pension Plan: Paid Only As Life Annuity

The pension plan was established in 1938 and pension benefits have always been company-paid. The pension plan provides monthly payments over the lifetime of the retired employee and his or her surviving spouse based on a formula of 1.6% for each year of service. In fact, a stream of monthly payments is the only form of distribution allowed for our pension plan; lump-sum distributions are not permitted (An exception is the case of a small pension which has a present value of $3,500 or less.) So, the pension plan plus Social Security provides monthly income to our retirees or their spouses.

2. Savings Plan: No Withdrawal of taxable amounts until retirement

In addition, the company has a qualified savings plan which has been in existence since 1939. This plan has a primary objective of providing supplemental retirement benefits in the form of an accumulation of retirement capital, but not necessarily a monthly stream of pension income payments. Currently, there are over 28,000 employee members of this plan. This plan ensures added financial security for employees when they retire from the Company by providing another source of income supplementing the monthly payments made by the Shell Pension Plan and Social Security. Traditionally, the Company has matched employee after-tax contributions up to 10% of an employee's salary. In recent years, employee contributions have not been required.

Prior to attaining age 59½, no withdrawals of Company contributions or earnings are permitted until retirement or termination of employment. Therefore, employees often accumulate large sums over 30-40 years of service in addition to a stream of monthly pension payments at retirement.

It is quite common for plant operators, craftsworkers, fuel delivery employees and clerical employees, when they retire, to receive taxable lump-sum distributions of $150,000 - $175,000. For example, in the past year, 410 (40%) of our retirements were from this group of employees. Our next largest group of retiring employees was first-line foremen and supervisors who typically have upon approval of the court, shall be paid by the United States marshal for the district—

"(1) on the certificate of a Federal public defender or assistant Federal public defender, in any such proceedings in which a party is represented by such Federal public defender or assistant Federal public defender, and

"(2) on the certificate of the clerk of the court upon the affidavit of such witnesses' attendance given by other counsel appointed pursuant to section 3006A of title 18, in any such proceedings in which a party is represented by such other counsel.

"(c) Fees and mileage need not be tendered to a witness upon service of a subpoena issued on behalf of the United States or an officer or agency of the United States, upon service of a subpoena issued on behalf of a defendant represented by a Federal public defender, assistant Federal public defender, or other attorney appointed pursuant to section 3006A of title 18, or upon service of a subpoena issued on behalf of a party authorized to proceed in forma pauperis, if the payment of such fees and mileage is to be made by the United States marshal under this section.".

SEC. 5. EFFECTIVE DATE.

The amendments made by this Act shall take effect on October 1, 1985, or 120 days after the date of the enactment of this Act, whichever is later.

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The impact of these proposals on our savings plan is severe, especially for those retiring and receiving their benefits prior to attaining age 59½.

Under S. 1784, our qualified savings plan would be classified as a "non-retirement" plan. Proposed changes in tax treatment include:

1) repeal of 10-year averaging and capital gains treatment for lump sum distributions (thus distributions would be taxed fully as ordinary income); and

2) increase the penalty for distribution from an Individual Retirement Account before age 59½ from 10% to 20%. This would affect those who roll over into an IRA, and then need funds before age 59½.

In virtually every lump-sum distribution case, the employee would be forced into the highest marginal tax bracket. The IRA penalty tax would be on top of the normal income tax.

The changes proposed in H.R. 3838 for taxing distributions from qualified retirement and savings plans generally include:

(1) elimination of the long established tax treatment on lump sum distributions, i.e., 10-year forward averaging and, for pre-1974 participation, long-term capital gains treatment; and replacement in certain circumstances with one election for 5-year forward averaging; and

(2) imposition of a 15% additional income tax (on top of income tax) on non-annuity distributions before age 59½; or

(3) imposition of a 15% excise tax (on top of income tax) on the aggregate amount of annual distributions to employees from qualified pension plans, savings plans (including 401(k) plans), employee stock ownership plans, and individual retirement accounts in excess of $112,500 (the "base"). There is an exception from this excise tax if the employee elects 5-year averaging for a lump-sum distribution. However, additional annuity retirement distributions from qualified plans (plus IRAs) received in the same year then become subject to the 15% excise tax.

It is clear that proposed changes in the tax treatment for retirement plans would affect a substantial number of taxpayers, including those in Shell's qualified savings plan. To illustrate the impact of these tax proposals we will impose both the Retirement Income Policy Act (S. 1784) and the retirement proposals of the House-passed tax reform bill (H.R. 3838) on typical participants in our savings plan to show the substantial increase in an employee's tax liability. The proposed retirement income tax treatment changes would have a heavy negative impact on many of these employees, especially those retiring and receiving their benefits prior to attaining age 59½.

Under the proposals of the Retirement Income Policy Act, the tax bill for the typical retiring Shell employee would increase by almost 200% (See Appendix A).

"(D) is under arrest, when such representation is required by law;

"(E) is entitled to appointment of counsel in parole proceedings under chapter 311 of this title;

"(F) is subject to a mental condition hearing under chapter 313 of this title;

"(G) is in custody as a material witness;

"(H) is entitled to appointment of counsel under the sixth amendment to the Constitution; or

"(I) faces loss of liberty in a case, and Federal law requires the appointment of counsel.

"(2) Whenever the United States magistrate or the court determines that the interests of justice so require, representation may be provided for any financially eligible person who—

"(A) is charged with a petty offense for which a sentence to confinement is authorized; or

"(B) is seeking relief under section 2241, 2254, or 2255 of title 28.

"(3) Private attorneys shall be appointed in a substantial proportion of the cases. Each plan may include, in addition to the provisions for private attorneys, either of the following or both:

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(2) Subsection (b) is amended—

(A) in the second sentence—

(i) by striking out "In every criminal case" and all that follows through "violation of probation and" and inserting in lieu thereof "In every case in which a person entitled to representation under a plan approved under subsection (a)"; and

(ii) by striking out "defendant"; and inserting in lieu thereof "person";

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(3)(A) Subsection (d)(1) is amended by striking out "not exceeding $60" and all that follows through "Such attorney" and inserting in lieu thereof the following: "not in excess of $50 per hour, unless the Judicial Conference determines that a higher rate of not in excess of $75 per hour is justified for a circuit or for particular districts within a circuit, for time ex-

receive lump-sum distributions from the impact of progressive tax rates on bunched income. Rules for 10-year averaging and capital gain treatment were provided by Congress to mitigate the unfairness of taxing -- at high tax rates -- an unusually large "lump" of income which was accumulated over many, many years. Such rules should be continued.

Retroactive Tax Increases

This proposal is particularly unfair in that it applies retroactively; that is, to account balances which were accumulated in reliance on decades of capital gains and/or 10-year averaging experience. Employees who have participated during these years are entitled to receive the established tax treatment that prompted their savings.

Our employees are very concerned about this retroactive increase in tax liability on accumulated savings. They say it is unconscionable. They believe consistency and fairness dictate that the tax rules upon which employees and employers have come to rely should not be changed retroactively, after savings decisions have been made for many years based on rules in existence at the time they elected to save. I think they are correct. Furthermore, a retroactive increase in tax on past accumulations in employees' accounts represents a dangerous precedent. In addition to altering retirement planning and increasing the retiree's tax bill, the ex post facto nature of the proposed change could cause taxpayers to lose confidence in the credibility of the government's tax policies. In the past, sucn tax law changes were applied prospectively only.

In the event Congress decides to adopt the proposal eliminating the established tax treatment now accorded to lump-sum distributions, it is absolutely essential to modify the proposal to permit the "grandfathering" of prior accruals. This type of grandfather rule has been used in previous lump-sum rule changes; e.g., Tax Reform Act of 1969 and Employee Retirement Income Security Act of 1974. This would afford employees the existing tax treatment they expect and thereby avoid retroactive taxation on "bunched income".

APPENDIX A

Effects of S. 1784 on Retirement Distributions

Taxable Distribution	Current Law Tax	Proposed Law Tax	
		Total $	% Incr.
$150,000	$22,650	$ 66,055	(192%)
$200,000	$33,275	$ 92,494	(178%)

NOTE: 1986 tax rates applied

investigative, expert, and other services without prior authorization if necessary for adequate representation. Except as provided in subparagraph (B) of this paragraph, the total cost of services obtained without prior authorization may not exceed $300 and expenses reasonably incurred.

"(B) The court, or the United States magistrate, if the services were rendered in a case disposed of entirely before the United States magistrate, may, in the interest of justice, and upon the finding that timely procurement of necessary services could not await prior authorization, approve payment for such services after they have been obtained, even if the cost of such services exceeds $300.".

(C) Subsection (e)(3) is amended by striking out "$300" and inserting in lieu thereof "$1,000".

(5)(A) Subsection (h)(2)(A) is amended by striking out ", similarly as under title 28, United States Code, section 605, and subject to the conditions of that section" and inserting in lieu thereof "in accordance with section 605 of title 28".

(B) Subsection (h)(2)(B) is amended in the third sentence by striking out "coming" and inserting in lieu thereof "next fiscal".

(C) Subsection (h) is amended by adding at the end the following:

"(3) MALPRACTICE AND NEGLIGENCE SUITS.—The Director of the Administrative Office of the United States Courts shall, to the extent the Director considers appropriate, provide representation for and hold harmless, or provide liability insurance for, any person who is an officer or employee of either a Federal Public Defender Organization, or a Community Defender Organization receiving periodic sustaining grants, which is established under this subsection, for money damages for injury, loss of liberty, loss of property, or personal injury or death arising from malpractice or negligence of any such officer or employee in furnishing representational services under this section while acting within the scope of that person's office or employment.".

(6) Subsection (j) is amended by inserting immediately before the period at the end of the first sentence the following: ", including funds for the continuing education and training of persons providing representational services under this section".

(7) Subsection (l) is amended—

(A) by striking out ", other than subsection (h) of section 1,"; and

(B) by striking out "Act" each place it appears and inserting in lieu thereof "section".

Senator HEINZ. All right. One other question, Mr. Rigg. I understand, you got 82-percent participation in your 401(k) plan today. Is that correct?

Mr. RIGG. That is correct.

Senator HEINZ. And you have only had the 401(k) part a few years. Is that correct?

Mr. RIGG. Yes.

Senator HEINZ. Before you had tax-free employee contributions, how high was the participation in your profit sharing?

Mr. RIGG. Right at 70 percent.

Senator HEINZ. 70 percent. All right. Does your 401(k) plan permit in-service withdrawals now for hardship?

Mr. RIGG. For hardship reasons only.

Senator HEINZ. What do you define that as?

Mr. RIGG. College education for children, emergency medical reasons, and the buying of a first home.

Senator HEINZ. And first home. If we had to limit the definition of hardship, could we tighten up on any of those?

Mr. RIGG. I think it's interesting to note that, of our retirees, only 30 percent of them have ever withdrawn any money out of the plan at all, and of that amount only 3.5 percent of the total dollars in their accounts was drawn out.

Senator HEINZ. What was that second statistic?

Mr. RIGG. 3.5 percent of their balances was all that was drawn out, of the 30 percent that withdrew out money.

Senator HEINZ. That is an extraordinary statistic. Of those amounts, what would you say has been the most prevalent reason for most of those withdrawals? Would it be the first home, would it be medical, would it be college, or what would it be?

Mr. RIGG. Probably medical would be the lowest, because we have a very comprehensive plan. I would suspect that it's college education and homes. There's one other factor that has recently come into it, and that is divorces, too.

Senator HEINZ. I beg your pardon?

Mr. RIGG. Divorce has had an impact in that area.

Senator HEINZ. That's certainly a hardship. [Laughter.]

Mr. RIGG. It depends which side.

Senator HEINZ. It can be catastrophic, depending on the State in which you live.

Mr. RIGG. That is correct.

Senator HEINZ. Very good. It would be very helpful to the committee, I think, Mr. Rigg, if you could provide us with additional information as to what the hardship reasons have been.

[The information follows:]

The information Senator Heinz requested is as follows:

Southland's profit-sharing plan provides:

"A withdrawal will be on account of hardship if (a) it is necessary in light of the Participant's immediate and heavy financial needs, (b) it does not exceed the amount required to meet the immediate financial need created by the hardship, and (c) it is not reasonably available from the Participant's other resources. Needs constituting financial hardship ordinarily will include, but not be limited to, (a) paying expenses caused by the death or serious illness of the Participant, the Participant's spouse, or the children, parents, grandparents, and siblings of either, (b) purchasing a principal residence for the Participant or making major repairs (those which normally do not recur within five years), major remodeling, or additions (other than swimming pools, patios, tennis courts, or similar items) thereto, (c) satisfying a court ordered or court approved division of property and related legal fees, and (d) paying for college and special education (not including primary or secondary schools) for the Participant, the Participant's spouse, or the children of either."

Other acceptable hardship reasons include the necessity of paying income taxes, back rent, house payments, or utilities; bankruptcy; and financial difficulties caused by the Participant's spouse's being laid off. Purchase of automobiles and automobile repairs are not acceptable reasons, unless it is the only transportation to work. Similarly, moving expenses are not acceptable reasons, unless the move was required by the Company. Reasons which are never acceptable are payment of charge cards, paying off existing loans, paying off mortgages, insurance payments, school clothes, private schools, payments on second homes, weddings, vacations, family assistance other than medical, investment property, and "I don't want to participate."

Senator HEINZ. I gather that your main concern, as has been expressed by others, is that if people don't feel that they can get at their savings if they really need them, if they are going to be, say, put in a safe deposit box every month, but the key is thrown away and won't be discovered until they are 59½ or 62 or 65, you are worried that this might be a perceived disincentive for participation.

Mr. RIGG. We think we have a good laboratory test of that, as I mentioned in my testimony. We have the same profit-sharing plan with the same provisions in it in Canada, but by Canadian law no one can withdraw their money until retirement. It is not a savings plan per se. Our enrollment there we struggle to keep at 50 percent.

Senator HEINZ. I see. As you are aware, unlike the administration's tax-reform proposal, we don't draw that hard line which says a dollar saved is a dollar locked up until you retire, for that very reason. I guess we agree on the principle. And the question is how do we implement the principle most effectively? I find your testimony interesting, because it appears to be much more perception, people's perception of their possible needs, than the reality of their actual needs.

Mr. GARBER. Mr. Chairman, that's our concern, too. It's perception more than reality. We don't believe that if you really work at describing to your employees that these are funds for their retirement, they're intended for that purpose and should be used for that purpose, that will be sufficient to deter a good deal of any withdrawal activity and misuse of the funds.

Senator HEINZ. I was going to ask you some questions next on a slightly different subject, Mr. Garber, and I am going to ask you another question, as well. Since there is some concern, more in the abstract, perhaps, than based on facts, that you could get into a situation where people started using their 401(k) profit-sharing plan for all the purposes just described. I mean, if you used it to pay for your first house and the mortgage on your first house, and you used it for college educations—you know, after you are married about 18 or 19 years, you start running into those creatures called college kids—and if you are the typical American, I guess the odds of encountering a divorce are frightening. It's not hard to imagine, at least in theory as opposed to the practice, a lot of those hardship withdrawals absolutely going in one end and coming right out, in effect, just a few years later, the other. Suppose there were an aggregate test; you companies control how you run those plans. Certainly the last thing Washington, DC, ought to be doing is figuring out whether divorce is a hardship or not, irrespective of whether or

"(2) on the certificate of the clerk of the court upon the affidavit of such witnesses' attendance given by other counsel appointed pursuant to section 3006A of title 18, in a criminal case in which a defendant is represented by such other counsel.

"(b) In proceedings in forma pauperis for a writ of habeas corpus, and in proceedings in forma pauperis under section 2255 of this title, the United States marshal for the district shall pay, on the certificate of the district judge, all fees of witnesses for the party authorized to proceed in forma pauperis, except that any fees of witnesses for such party, other than experts, appearing pursuant to subpoenas issued upon approval of the court, shall be paid by the United States marshal for the district—

"(1) on the certificate of a Federal public defender or assistant Federal public defender, in any such proceedings in which a party is represented by such Federal public defender or assistant Federal public defender, and

"(2) on the certificate of the clerk of the court upon the affidavit of such witnesses' attendance given by other counsel appointed pursuant to section 3006A of title 18, in any such proceedings in which a party is represented by such other counsel.

"(c) Fees and mileage need not be tendered to a witness upon service of a subpoena issued on behalf of the United States or an officer or agency of the United States, upon service of a subpoena issued on behalf of a defendant represented by a Federal public defender, assistant Federal public defender, or other attorney appointed pursuant to section 3006A of title 18, or upon service of a subpoena issued on behalf of a party authorized to proceed in forma pauperis, if the payment of such fees and mileage is to be made by the United States marshal under this section.".

SEC. 5. EFFECTIVE DATE.

The amendments made by this Act shall take effect on October 1, 1986, or 120 days after the date of the enactment of this Act, whichever is later.

notion of hardship, conventionally, at any rate, connotes the notion of unexpectedness. And why shouldn't the definition of hardship be a substantial unanticipated expense? Why shouldn't that be the basic standard? Mr. Garber?

Mr. GARBER. It seems reasonable to me.

Senator HEINZ. Mr. Whittington?

Mr. WHITTINGTON. I think it's reasonable. To the extent that employees do recognize that they have less opportunity to withdraw, they are less likely to save, absent other incentives.

Senator HEINZ. Mr. Rigg?

Mr. RIGG. I think it would take some time to implement that type of philosophy, because we have people now who are counting on some of that money, whether it's "hardship" or not hardship, to put their children through school or to buy that first house. It would take some time for them to get over the fact that they wouldn't have any funds available. Your proposal has the interesting part of it, where you have the retirement portion and the savings portion, and we would find that, perhaps, more acceptable than having a "no-hardship" or extremely tight hardship qualifier.

Senator HEINZ. Where savings is concerned, you would have a perhaps more flexible kind of rule.

Mr. RIGG. Yes. And that was our concern when we talked about the 3-percent rule. If you modify the 3-percent rule, we would probably change our plan to where the company contributions would go into the retirement side. The employee could elect to put their funds either on a pre-tax or post-tax basis into the retirement side or into the savings side. And that, therefore, would give them a cushion.

Senator HEINZ. I just want to note the arrival of my constituent, Mr. Weizmann. We welcome you, Mr. Weizmann.

Mr. WEIZMANN. I apologize for being late tonight.

Senator HEINZ. I think you have nothing to apologize for; it's the miserable weather between here and Greater Philadelphia Airport, I think, that did you in.

Mr. WEIZMANN. Yes.

Senator HEINZ. The other witnesses have given their testimony. Would you care to give us your——

Mr. WEIZMANN. Yes, I would like to make a few comments, basically because we take great pleasure in being here. We were beginning to believe that the same people who broke up the telephone company were planning national retirement policy.

Senator HEINZ. So far Judge Green has not been able to get his hands on that. [Laughter.]

STATEMENT OF HOWARD C. WEIZMANN, MANAGER, BENEFITS PLANNING AND DESIGN, THE SUN CO., INC., RADNOR, PA

Mr. WEIZMANN. If I might call it RIPA, we do like the bill. We like it in a number of respects. Those of us who live outside the beltway were beginning to think that the same people who broke up the phone company had gotten their hands on retirement income policy.

Senator HEINZ. And you are saying our bill will not do for pensions what Judge Green did for the telephone.

Mr. WEIZMANN. Yes; I want to make that absolutely clear, Senator.

Senator HEINZ. I saw a lot of people sitting over at the press table, and I didn't want them to misinterpret a thing you said. [Laughter.]

Mr. WEIZMANN. For a long time we have seen legislation which has come down the pike. I list it in my testimony, but just to remind you, in 1974, 1975, 1976, 1978, 1979, 1980, 1981, 1982, twice in 1984, and Senator, quite frankly, we're getting weary of legislation in this area. We are currently still trying to figure out what the Tax Reform Act of 1984 said.

Senator HEINZ. So are we.

Mr. WEIZMANN. And the Retirement Equity Act——

Senator HEINZ. We wrote it, too.

Mr. WEIZMANN. That's right. I'm reminded of a line I've quoted often, from T. S. Eliot, who said, when he wrote "The Wasteland," he said, "When I wrote it, only God and I knew what it meant, and today only God knows." [Laughter.]

Senator HEINZ. That's very reassuring. [Laughter.]

Mr. WEIZMANN. But when it comes to national policy, we find that the Retirement Income Policy Act, in effect, addresses issues head-on. We don't agree with everything in the bill, we like some things better than we like other things; at the same time we recognize the context in which it occurs.

If I may be more specific, when we look at the plan limitations proposals, for example, as providing a meaningful balance between providing, the necessity of providing reasonable incentives, providing adequate retirement income, and also allowing employers to do it in a fashion which assures minimal equity, at the same time without undue administrative complexity. I am reminded of what you recently, or just most—a few moments ago—talked about the "yuppie" who was an engineer. That engineer probably would have had retirement income, or, I'm sorry, current compensation in excess of $50,000 and probably would have fallen into that restricted class under the Tax Reform Act, H.R. 3838, and as such would have had contributions severely limited to him under a 401(k) plan.

When he formed his own company, more than likely he would have been in the prohibitive group under the rules which constrain small companies and as such would have been limited in terms of the amount of contribution that could have been put in, or he could have put in on behalf of himself. The Retirement Income Policy Act does away with all of those things.

First of all, it makes sensible breakdown between retirement plans and also savings plans; at the same time, when it comes to plan limitations, it preserves the essence of the current rules under 401(k), provides a meaningful incentive under 401(k) in terms of the amount of pre-tax dollars that could be put away. At the same time, it preserves the current discrimination rules which, granted, while perhaps not perfect, are administratively feasible, they're comprehensible to the average employee and, quite frankly, make the plan an attractive alternative to a formal retirement plan, which, in fact, it is.

The other thing that we like particularly well is the recognition that Social Security integration today is a problem for everyone,

(D) Subsection (d)(4) is amended in the first sentence by striking out "represented the defendant" and inserting in lieu thereof "provided representation to the person involved".

(4)(A) Subsectikn (e)(1) is amended in the first sentence by striking out "an adequate defense" and inserting in lieu thereof "adequate representation".

(B) Subsection (e)(2) is amended to read as follows:

"(2) Without Prior Request.—(A) Counsel appointed under this section may obtain, subject to later review, investigative, expert, and other services without prior authorization if necessary for adequate representation. Except as provided in subparagraph (B) of this paragraph, the total cost of services obtained without prior authorization may not exceed $300 and expenses reasonably incurred.

"(B) The court, or the United States magistrate, if the services were rendered in a case disposed of entirely before the United States magistrate, may, in the interest of justice, and upon the finding that timely procurement of necessary services could not await prior authorization, approve payment for such services after they have been obtained, even if the cost of such services exceeds $300.".

(C) Subsection (e)(3) is amended by striking out "$300" and inserting in lieu thereof "$1,000".

(5)(A) Subsection (h)(2)(A) is amended by striking out ", similarly as under title 28, United States Code, section 605, and subject to the conditions of that section" and inserting in lieu thereof "in accordance with section 605 of title 28".

(B) Subsection (h)(2)(B) is amended in the third sentence by striking out "coming" and inserting in lieu thereof "next fiscal".

(C) Subsection (h) is amended by adding at the end the following:

"(3) Malpractice and Negligence Suits.—The Director of the Administrative Office of the United States Courts shall, to the extent the Director considers appropriate, provide representation for and hold harmless, or provide liability insurance for, any person who is an officer or employee of either a Federal Public Defender Organization, or a Community Defender Organization receiving periodic sustaining grants, which is established under this subsection, for money damages for ijjury, loss of liberty, loss of property, or personal injury or death arising from malpractice or negligence of any such officer or employee in furnishing representational services under this section while acting within the scope of that person's office or employment.".

(6) Subsection (j) is amended by inserting immediately before the period at the end of the first sentence the following: ", including funds for the continuing education and training of persons providing representational services under this section".

(7) Subsection (l) is amended—

(A) by striking out ", other than subsection (h) of section 1,"; and

(B) by striking out "Act" each place it appears and inserting in lieu thereof "section".

(b) Technical Amendments.—

(1) Section 3006A of title 18, United States Code, is amended by striking out subsection (g) and redesignating subsections (h) through (l) as subsections (g) through (k), respectively.

(2) Subsection (j) of section 3006A of such title, as redesignated by paragraph (1), is amended to read as follows:

"(j) Districts Included.—As used in this section, the term 'district court' means each district court of the United States created by chapter 5 of title 28, the District Court of the Virgin Islands, the District Court for the Northern Mariana Islands, and the District Court of Guam.".

SEC. 3. AMENDMENTS TO COMPREHENSIVE CRIME CONTROL ACT OF 1984.

Section 223(e) of the Comprehensive Crime Control Act of 1984 (Public Law 98-473; 98 Stat. 2028) is amended to read as follows:

"(e) Section 3006A(a) is amended—

"(1) in paragraph (1)(A) by striking out 'misdemeanor (other than a petty offense as defined in section 1 of this title)' and inserting in lieu thereof 'Class A misdemeanor';

"(2) in paragraph (1) by striking out subparagraph (E) and redesignating subparagraphs (F) through (I) as subparagraphs (E) through (H), respectively; and

"(3) in paragraph (2)(A) by striking out 'petty offense' and inserting in lieu thereof 'Class B or C misdemeanor, or an infraction,'.".

SEC. 4. WITNESS FEES.

Section 1825 of title 28, United States Code, is amended to read as follows:

"§1825. Payment of fees

"(a) In any case in which the United States or an officer or agency of the United States is a party, the United States marshal for the district shall pay all fees of witnesses on the certificate of the United States attorney or assistant United States attorney, and in the proceedings before a United States magistrate, on the certificate of such magistrate, except that any fees of defense witnesses, other than experts, appearing pursuant to subpoenas issued upon approval of the court, shall be paid by the United States marshal for the district—

"(1) on the certificate of a Federal public defender or assistant Federal public defender, in a criminal case in which the defendant is represented by such Federal public defender or assistant Federal public defender, and

"(2) on the certificate of the clerk of the court upon the affidavit of such witnesses' attendance given by other counsel appointed pursuant to section 3006A of title 18, in a criminal case in which a defendant is represented by such other counsel.

"(b) In proceedings in forma pauperis for a writ of habeas corpus, and in proceedings in forma pauperis under section 2255 of this title, the United States marshal for the district shall pay, on the certificate of the district judge, all fees of witnesses for the party authorized to proceed in forma pauperis, except that any fees of witnesses for such party, other than experts, appearing pursuant to subpoenas issued upon approval of the court, shall be paid by the United States marshal for the district—

"(1) on the certificate of a Federal public defender or assistant Federal public defender, in any such proceedings in which a party is represented by such Federal public defender or assistant Federal public defender, and

"(2) on the certificate of the clerk of the court upon the affidavit of such witnesses' attendance given by other counsel appointed pursuant to section 3006A of title 18, in any such proceedings in which a party is represented by such other counsel.

"(c) Fees and mileage need not be tendered to a witness upon service of a subpoena issued on behalf of the United States or an officer or agency of the United States, upon service of a subpoena issued on behalf of a defendant represented by a Federal public defender, assistant Federal public defender, or other attorney appointed pursuant to section 3006A of title 18, or upon service of a subpoena issued on behalf of a party authorized to proceed in forma pauperis, if the payment of such fees and mileage is to be made by the United States marshal under this section.".

SEC. 5. EFFECTIVE DATE.

The amendments made by this Act shall take effect on October 1, 1986, or 120 days after the date of the enactment of this Act, whichever is later.

STATEMENT

H.R. 3004 updates the Criminal Justice Act (CJA) (18 United States Code § 3006A), which provides a system of compensation to attorneys to enable them to represent persons who are financially unable to obtain adequate representation in Federal court on criminal and related matters. The primary impetus for the revision of the CJA comes from Federal judges through the Judicial Conference of the United States (Judicial Conference) which has indicated its concern that the compensation system presents a threat to the Congressional purpose of providing adequate representation under the Sixth Amendment to those individuals unable to reasonably afford defense services.

The Sixth Amendment to the U.S. Constitution guarantees defendants in criminal cases the right to effective assistance of counsel. If counsel is not competent, the integrity of the justice system is jeopardized. Innocent defendants may be wrongly convicted, and defendants inadequately represented may have their cases retried or dismissed, regardless of their culpability. It is therefore critical that qualified attorneys be encouraged to represent financially eligible defendants, and that adequate compensation be set to insure rules of dubious value to anyone save the legion of consultants and lawyers who advise employers on employee benefits.

Into this arena enters S.1784. As you will see from our comments, we feel that this Bill is not perfect. Unlike previous legislative efforts, however, S.1784 represents a positive, far-reaching attempt to articulate a national retirement policy. The result is a piece of legislation which contains many elements which make good sense and good sense makes good policy.

Consequently, we support the substitution of many of the changes contained in S.1784 for similar provisions contained in H.R.3838. Specifically, we support the approach as taken regarding integration with social security, plan limitations, and effective dates.
We could also support the approach as taken with regard to retirement and savings plans and plan distributions provided some modifications were made. In fact, the only area where we feel that further refinement is needed is in the coverage area.

More than just supporting S.1784, we support the process that breathed life into this Bill. Experts and employers were consulted, various approaches debated before positions were formulated, and public comment, as represented by these hearings, solicited. What emerged was not change in search of a policy, but a statement of meaningful objectives and a blueprint for achieving those objectives. As a consequence, we are confident that this process will yield meaningful solutions to the areas of RIPA with which we do not agree.

The following discussion centers on these policies and, where possible, contrasts them with provisions contained within the H.R.3838.

1. Retirement v. Savings Plans

Today, employers provide programs which are aimed at both retirement income and capital accumulation. The former focuses on replacing income at retirement, while the latter encourages employees to save for life contingencies such as housing, education or even to supplement retirement income. S.1784 recognizes the distinction between the two types of plans, providing an intellectual basis for differing tax incentives.

Tax incentives today recognize no such distinction between retirement and savings plans but instead provide the same level of incentives for both. This has contributed to a muddle of tax legislation which seeks to promote retirement over savings, defined benefit plans over defined contribution plans, or vice versa. The most recent example of this muddle is contained in the Tax Reform Bill which would seek to "lock up" both retirement and savings income without distinction.

Our experience has been that employees will not save if they believe that access to their funds will be significantly limited. From 1926 until 1975, Sun maintained a class year stock purchase plan under which employee contributions were matched by Sun. Funds under the plan would "roll-out" to employees each year after an initial 5 year period. Participation in this plan ranged above 75%.

In 1975, we tried to improve the amount of money being devoted towards retirement so we redesigned the stock purchase plan. Under the new savings plan, the employer match was improved and employees were vested in their account immediately. However, the plan did not permit withdrawals from the employee accounts. Given the option to stay in the old stock purchase plan or enter the new savings plan, most employees

Conference again requested new legislation.[6] An excerpt from the letter follows:

> There is increasing concern at all levels of the Federal Judiciary that further delay in implementing the proposed amendments will seriously threaten the availability of experienced and qualified counsel willing to accept appointment under the Act and may significantly erode the quality of legal services which the Sixth Amendment to the Constitution mandates.
>
> The General Accounting Office, in its recent report on the admijistration of the Criminal Justice Act (GAO/GGD-83-18), stated the "real value [of the fees currently paid to court appointed attorneys under the CJA] has obviously decreased substantially because of inflation. On this basis alone they deserve examination".

In response to this communication, H.R. 3233 was introduced by Representatives Robert W. Kastenmeier and Mike Lowery. Two days of hearings (June 30 and July 14, 1983) were held on the proposal before the Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. All witnesses at the hearings urged the Subcommittee to update the Act so that defendants and certain other persons qualifying for the appointment of counsel could be assured of adequate representation, and so that qualified attorneys would continue to provide services.

On September 15 and October 20, 1983, the Subcommittee on Courts, Civil Liberties and the Administration of Justice marked up H.R. 3233, and unanimously recommended that a clean bill be referred to the full Committee. That bill, H.R. 4307, was introduced on November 3, 1983, and was cosponsored by all the members of the Subcommittee. H.R. 4307 was more fiscally conservative than H.R. 3233, the original Judicial Conference proposal. In addition, it reflected certain changes suggested by the Department of Justice. The legislation was approved by the Committee on May 1, 1984, without objection, and a report was filed on May 15, 1984 (H. Rept. 98-764). The bill was considered under Suspension of the Rules and passed by voice vote on May 21, 1984. Although the Senate Judiciary Subcommittee on the Constitution held a hearing (September 11, 1984) on H.R. 4307 and a companion bill, S. 2402, no further action was taken. However, a modest amendment to the CJA was enacted in the Comprehensive Crime Control Act of 1984 (CCCA) (discussed above).

During this Congress, the Judicial Conference submitted a further request that legislation be enacted similar to H.R. 4307 (98th Congress), and with an additional provision relating to the certification for payment of defense fact witness fees. H.R. 3004 was introduced on July 16, 1985, by Chairman Robert W. Kastenmeier and Ranking Minority Member Carlos J. Moorhead of the Subcommittee on Courts, Civil Liberties and the Administration of Justice. (A similar bill, S. 1581, was introduced on August 1, 1985, by Senators Thurmond and Mathias.) A hearing was held on July 25, 1985, and the legislation was ordered reported favorably to the full Committee with a minor amendment on October 1, 1985. The full Committee ordered that H.R. 3004 be reported favorably on November 19, 1985, including the Subcommittee's amendment changing the word "competency" to "condition" in section 2 to conform to the CCCA, and delaying the effective date to October 1, 1986, or later.

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[6] Letter dated Apr. 7, 1983, from Hon. William E. Foley, then Director of the Administrative Office of the U.S. Courts, to Hon. Thomas P. O'Neill, Jr., Speaker of the House, with attached legislative proposal.

H.R. 3004 updates the CJA in the following manner. H.R. 3004 sets a general maximum rate of $50 per hour. The Judicial Conference would be authorized to approve higher rates up to a maximum of $75 per hour. No distinction is made between in-court and out-of-court time. These figures were reached by reviewing surveys of circuits conducted by the Administrative Office of the U.S. Courts and by considering the geographic cost-of-living differentials and increases since 1970. From January 1971 until May 1985, the increase in the cost of living, according to the Bureau of Labor Statistics, was 170%. The Judicial Conference in consultation with the judicial councils of the circuits may vary the rates by district considering factors such as the minimum range of prevailing rates for qualified attorneys in the district. Three years after the effective date of the Act (October 1, 1986 or later), the hourly rates may be raised consistent with cost-of-living raises granted to Federal employees, but only if the Judicial Conference decides it is appropriate. A cost-of-living increase is not mandatory after three years, but is left to the discretion of the Judicial Conference. H.R. 3004 raises the maximum payment per case to $5,000 for a felony, $1,500 for a misdemeanor, $3,000 for an appeal, $1,000 for other proceedings, and raises support services (e.g., investigative and expert services) to $1,000 with permission or nunc pro tunc authorization under certain circumstances, or $300 without advance permission. Case maximums for attorney compensation and expert or other services may be waived if the court issues the appropriate certification and payment is approved by the chief judge of the circuit.

H.R. 3004 also makes other improvements recommended by the Judicial Conference including allowing the option of malpractice insurance for Federal defenders or providing representation and holding them harmless, appointment of counsel in certain petty offenses, mandating appointment of counsel for financially eligible material witnesses in custody, and the continuing education and training of panel attorneys. It also removes a restriction placed in the Act in 1970 which precludes the U.S. District Court for the District of Columbia from establishing a Federal Defender Organization. The Chief Judges of the U.S. District Court (D.C.) and of the Court of Appeals (D.C. Circuit) have supported the repeal of this restriction. Thus, the D.C. Circuit will, as all other circuits, have the option of creating a mixed private bar/public defender system. H.R. 3004 amends section 1825 of title 28, United States Code, to authorize Federal public defenders and their assistants appointed under the CJA to certify the payment of defense fact witness in Federal criminal cases. In those cases where representation is furnished by other counsel appointed under the CJA—private panel attorneys or attorneys furnished by a Community Defender Organization—defense fact witnesses would be certified by the clerk of the district court upon the affadavit of the witnesses' attendance by employees to save. While we would prefer that the current Section 401(k) contribution limits be retained, the fact that the current discrimination rules stay essentially the same and that the limit is, in effect, indexed to the Social Security wage base makes these changes acceptable. We would suggest, however, that the 500% cap on compensation be raised or removed.

These provisions contrast dramatically with those of the Tax Reform proposals. Those provisions would (1) significantly reduce the defined benefit limits to levels which would impair the funding for 60% of Sun's employees, (2) reduce the annual defined contribution limits and the relative value of defined contribution plans compared to defined benefit plans, (3) continue to impose the combined plan limitations, and (4) impose an excise tax on distributions above $112,500. This approach would significantly reduce the incentives available in such plans while imposing complex rules of dubious result which will lead to the kind of tax gamesmanship that tax reform was intended to eliminate.

Moreover, the proposed Section 401(k) limitations under H.R.3838 will provide not only for the reduction of the maximum contributions under Section 401(k) plans to $7,000, but will significantly complicate the current tests used to measure discrimination. Under the proposed rules, employees would now have a more restrictive discrimination test applied to a nationally deemed "prohibited group" rather than the current relative measure used to determine highly compensated employees. Employers would also now have to test matching contributions under an equally restrictive test. All of these rules are imposed despite the fact that survey after survey of Section 401(k) plans have demonstrated that the current incentives result in a reasonable distribution of benefits between the higher and lower paid employees. No showing to the contrary has been demonstrated.

Moreover, no showing as to the impact on savings rates under 401(k) plans of these reduced incentives (especially when considered in an environment of reduced personal tax rates) and new complex discrimination tests has likewise been presented. Nor has it been demonstrated that the marginal increase in equity to be achieved by these rules outweighs the cost of redesigning 401(k) programs and administering them under the proposed set of complex rules. Curiously, no similar limitations are proposed for individual retirement accounts which have been demonstrated to be principally used by higher paid individuals. As a consequence, we can only conclude that unlike S.1784 the Tax Reform proposals are an unprovoked case of severe overregulation of what to date has proven to be a remarkably successful savings incentive.

3. Integration

S.1784 would establish new and simple integration rules for excess and offset plans. The provisions would also eliminate excess only plans. As a result, RIPA implicitly recognizes the principle of integration, while curbing some of the excesses of old approach. Consequently, we applaud the RIPA integration proposals. As with plan limitations, the RIPA approach would greatly simplify an area long recognized as one of meaningless complexity.

4. Vesting and Portability

S.1784 would shorten the maximum permissible vesting period under qualified plans to 5 years. The bill would also permit employers to direct the payment of account balances to an IRA upon termination of service.

The costs of this bill fall within budget function 750.

Basis of estimate: Under current law court-appointed attorneys are authorized up to $40 per hour for work done out of court and $60 per hour for in-court work time. This bill authorizes payment of a flat $50 per hour to such attorneys, with an allowance for an increase to $75 per hour in certain high-cost districts. CBO has estimated the potential budget impact of the change in payment limit, based on information from the Criminal Justice Act Division of the Administrative Office of the U.S. Courts. The estimate assumes that the workload for court-appointed attorneys will continue at its current rate, and that the judicial districts that have indicated to the Administrative Office that they would seek to raise the maximum hourly compensation rate to $75 would be allowed to do so. It further assumes that the Administrative Office would raise the rate by 20.5 percent in fiscal year 1990 based on the federal pay-raise increases assumed for fiscal year 1987 and 1988 in the First Concurrent Resolution on the Budget—Fiscal Year 1986, and CBO projections for fiscal years 1989 and 1990. For the purpose of this estimate, it is assumed that the AOUSC would purchase liability insurance, rather than pay judgments on behalf of employees of a federal public defender or community defender organization. The liability insurance and attorney training provisions in the bill are expected to cost a total of about $300,000 per year.

6. Estimated cost to State and local governments: None.
7. Estimate comparison: None.
8. Previous CBO estimate: None.
9. Estimate prepared by: Debra Goldberg.
10. Estimate approved by: C.G. Nuckols (for James L. Blum, Assistant Director for Budget Analysis).

SECTION-BY-SECTION ANALYSIS

Section 1 provides that the Act may be cited as "the Criminal Justice Act Revision of 1985".

Section 2 amends 18 U.S.C. 3006A in the following manner:

(a) Adequate representation of defendants

Subsection (a) has been restructured for purposes of clarity and to incorporate changes in the law since the last comprehensive revision of the Criminal Justice Act (hereinafter referred to as "CJA") in 1970. Mandatory appointments are listed in paragraph (a)(1) and discretionary appointments (previously found in subsection (g)) are now located directly below in paragraph (a)(2).

Paragraph (a)(1) has been amended to provide separately for mandatory representation of those charged with juvenile delinquency, a probation violation, or a felony or misdemeanor. Thus, subparagraph (a)(1)(A) provides for mandatory representation when a felony or misdemeanor is charged, subparagraph (a)(1)(B) provides for the mandatory representation of those charged with juvenile delinquency, and subparagraph (a)(1)(C) provides for mandatory representation of those alleged to have violated probation. The language of subparagraph (a)(1)(B) has also been changed slightly to conform with the provisions of chapter 403 of title 18, United States Code, entitled "Juvenile Delinquency."

Subparagraph (a)(1)(E) conforms the language of the CJA to that of the Parole Commission and Reorganization Act of 1976. The new language makes it clear that appointment of counsel under the CJA is mandatory in parole matters when so provided in the Parole Commission and Reorganization Act. (See comments below relating to Section 3 of the bill which further amends the CJA to eliminate references to parole in accordance with the Comprehensive Crime Control Act of 1984 (CCCA), title II, P.L. 98-473, 98 Stat. 1837, October 12, 1984).

Subparagraph (a)(1)(G) makes appointment of counsel mandatory for a material witness who is in custody, and not discretionary as currently provided in subsection (g). The Bail Reform Act of 1984, enacted as chapter I of the CCCA, provided for mandatory representation by appointed counsel at a detention hearing for a financially eligible person arrested as a material witness (See Sections 3144 and 3142(f) of title 18, United States Code). This requirement is incorporated into the CJA through the operation of current paragraph (a)(2) of the CJA which provides for the furnishing of representation to a person "who is under arrest when such representation is required by law," as well as current paragraph (a)(5) which provides for the representation of a person "for whom, in a case in which he faces loss of liberty, any Federal law requires the appointment of counsel." However, subsection (g) continues to provide discretionary authority for the appointment of counsel to represent a material witness in custody and, presumably, encompasses representation at every stage of such proceedings including the giving of a deposition by the material witness. Since the mandatory appointment provision of the Bail Reform Act of 1984 onhy refers to representation at the detention hearing, it is unclear whether the appkintment of counsel to assist materiah witnesses ij custody at depositikns remaijs within the discretioj of the presiding judge or magistrate. Amending the CJA to require the appointment of counsel for material witnesses will (1) eliminate any questions concerning the entitlement to representation throughout the material witness proceedings, (2) be consistent with what already is the general practice in a number of districts, and (3) reflect the view of the Judicial Conference that any person held in custody against his or her will, whether as a defendant or one designated by a party as material witness, should have the assistance of an attorney in exercising all rights provided by law.

Subparagraphs (a)(1)(H) and (a)(1)(I) make no substantive change, but merely separate into two subparagraphs the provision appearing in current paragraph (a)(5).

Paragraph (a)(2) replaces current subsection (g) and lists those cases in which appointment of counsel is discretionary.

Subparagraph (a)(2)(A) is new and permits the appointment of counsel, as a matter of discretion, in petty offense cases where a sentence of confinement is authorized. At present, the language of the CJA excludes appointment of counsel in petty offense cases. However, as a result of two Supreme Court decisions, there are some petty offense cases and situations in which appointment of counsel is now required. In the first decision, *Argersinger* v. *Hamlin,* 407 U.S. 24 (1972), the Court held that under the Sixth Amendment to the Constitution an indigent defendant is entitled unduly restrictive and does not present a practical solution. Moreover, we continue to suggest that in the case of contributory plans (except as to Section 401(k) contributions) that the standard be eligibility to participate and not actual participation. Under the special participation test, contributory plans which are retirement plans will fail to provide a "meaningful retirement benefit" if the percentage of participating employees drops below 70% (60% in the case of other retirement plans). This is an onerous result where employers have very little control over the rate of savings of their employees.

Finally, use of the current comparability rules within an "allowable subdivision" would effectively do away with the salaried/hourly distinction. We feel this is unjustified since differences in salaried and hourly benefit levels result from justifiable distinctions in the workforce. Generally, non-union hourly plans are maintained at levels which are comparable to, or better than, collectively bargained plans. If salaried/hourly distinction is abolished, we would in effect, preserve a coverage exception for collectively bargained plans, but require non-union hourly plans with comparable or better benefit levels to be aggregated with salaried plans. Thus, two similarly situated populations of employees would be treated differently as a result of the proposed coverage test. Furthermore, this approach in many instances would raise the employer's cost of benefits for non-collectively bargained employees to levels which could not be financially sustained by employers.

In sum, we would strongly argue in favor of preserving current law as to coverage. At the very least, we would argue that the area of coverage be studied further. Moreover, we urge that S.1784 be amended to permit benefit distinctions between salaried and hourly workforces so long as adequate coverage of both groups is assured.

7. Effective Dates

Amendments made by this legislation are effective no earlier than two years following enactment but in any case, no later than December 31, 1990. We support this approach.

Congress has often assumed that the resources of employers (both in money and manpower) are infinite. As a consequence, recent legislation has not provided adequate lead time to redesign programs and communicate changes to employees. The result is that effective dates contained in such legislation have lost much of their credibilty. In contrast, the effective dates contained in S.1784 reflect an enlightened view of the capabilities of individual employers and their employees to assimilate complex changes in their retirement programs.

Senator **Heinz**. One of the recurring themes of our discussion was employees' anticipations, their perceptions of their needs, and there's a great deal of psychology that may be very different from reality here, but the psychology is important as to whether people, quite understandably, make decisions today to defer from present consumption for needs at a later time. That is a very abstract process for all the other animals that God created on the Earth. I forget whether T.S. Eliot put any of them under the red rock in The Wasteland.

But let me just pursue a couple of issues with you, Mr. Weizmann. You have a defined benefit plan at Sun, and it is supplemented by a savings plan with a 401(k) feature. How would you have to modify your plans at Sun if the retirement-nonretirement savings distinction in our bill were enacted?

Mr. **Weizmann**. Well, as far as the retirement plan providing the meaningful benefit, that would continue to be our defined benefit plan. That plan is in excess of the minimums included in the proposal under the bill. As far as our savings plan, it is a 401(k) plan, matched dollar for dollar by Sun. We learned some time ago that locking up money on the part of the employee when he or she makes his contribution, or her contribution, in fact will not encourage employees to save, and I have the example set forth in my testimony. Quite frankly, on our 401(k) side, we have made the matching contribution available after 2 years, a 2-year period in which it sets in the plan, which is the earliest that the law currently would allow.

As far as the 401(k) money goes, the employer contributes on a pre-tax basis, that continues to be locked up until termination of

The provision for setting an alternate hourly rate would restore at least some of the flexibility and viability which the Congress created when, in 1970, it amended paragraph (d)(1) of the CJA to authorize judicial councils to set alternate hourly rates for districts, "not to exceed the minimum hourly scale established by a bar association for similar services rendered in the district." This goal was subsequently frustrated by the abolishment of minimum bar fee schedules following the decision of the Supreme Court in *Goldfarb* v. *Virginia State Bar,* 421 U.S. 773 (1975), which held that a minimum fee schedule promulgated and enforced by a bar association constitutes unlawful price-fixing in violation of the Sherman Act. The *Goldfarb* decision thus resulted in a collateral deactivation of the adjustment authority conferred by Congress in the Circuit Councils. In *Mills* v. *United States,* 713 F. 2d 1249, (7th Cir. 1983), *cert. denied,* 464 U.S. 1069 (1984), the Court of Appeals for the Seventh Circuit held that, in the absence of a local bar association minimum fee schedule, the Judicial Council for the Seventh Circuit lacked authority to increase the hourly rates payable to attorneys accepting appointments under the CJA above the $20 and $30 maximums. While the CJA Revision of 1984 removed the 1970 language authorizing judicial councils to set alternate hourly rates, it made no provision to replace this mechanism for affording flexibility to the CJA compensation scheme.

In addition H.R. 3004 would authorize, but not require, the Judicial Conference to annually increase the $50 and $75 maximums up to the Federal pay comparability raises, if any, given to Federal employees. Thus, the CJA would include a limited mechanism for administrative adjustment of the compensation rates to provide for fair and reasonable compensation to counsel in light of future changes in economic conditions. This authority would not become operative until three years after the effective date of the proposed legislation.

Finally, in view of the increase in hourly rates, proposed paragraph (d)(2) would increase the overall per-case compensation maximums to $5,000 for felonies, $1,500 for misdemeanors, $3,000 for appeals and $1,000 for any other representation provided under the CJA. Cases falling within subsection (g) of the current law would be included in the new "other representation" category. Also included would be cases brought within the scope of the CJA under subparagraph (a)(1)(I) (current paragraph (a)(5)), as a result of judicial decisions or new Federal statutes which may require the appointment of counsel. The need for this provision was most recently demonstrated by the enactment of the Insanity Defense Reform Act of 1984 (Chapter IV of the CCCA) which amended the CJA to provide for representation at certain mental competency proceedings but failed to include a case compensation maximum for such appointments.

(D)(3) Waiving maximum amounts

While amendments to paragraph (d)(2) made by H.R. 3004 allow for some variation among the districts with respect to the maximum hourly rate, and also contain a limited mechanism to permit raises to the hourly maximum to reflect increases in the cost of living, the case compensation maximums established by the new paragraph (d)(2) are limits to be applied in every district and circuit and may not be increased by the Judicial Conference. Thus, attorneys in districts where a higher hourly rate has been established under paragraph (d)(2) may reach the case compensation limit after expending fewer hours than attorneys in districts where the lower hourly rate is in effect. In order to avoid an erosion of the flexibility intended in the compensation scheme set forth in paragraph (d)(2), the standard for waiving the maximum amount has been broadened—the judicial officers' authority to certify compensation in excess of the maximum would no longer be limited to those cases which are "extended and complex". Under the new standard, the maximum could be waived by the chief judge of the court of appeals upon the certification of the presiding judicial officer that excess payment is necessary to provide "fair compensation".

The case compensation ceilings would also be effectively lowered if the Judicial Conference approved higher hourly rates based upon Federal pay comparability increases. The proposed waiver standard will permit the full realization of the benefits of such adjustments.

(d)(4) Filing claims

The word "person" has been substituted for "defendant".

(e) Services other than counsel

(e)(1) Upon request

The phrase "adequate representation" has been inserted in lieu of "an adequate defense".

(e)(2) Without prior request

The modest increase from $150 to $300 as the amount which may be incurred for expert services without prior authorization takes into account the dramatic increase in the cost of these services which has occurred since this limit was established in 1970. In addition, paragraph (e)(2) has been split into subparagraphs (A) and (B). Subparagraph (A) is substantially identical to current paragraph (e)(2), the exception being the substitution of "representation" for "defense", the increased dollar limitation, and the reference to subparagraph (B). Subparagraph (B) is a new provision which allows the judge or magistrate to approve a claim for investigative, expert, or other services obtained by appointed counsel, even though prior authorization has not been secured and the amount of the claim exceeds the new limit established by subparagraph (A). However, subparagraph (B) would limit the discretion of judicial officers to provided this ratification to those circumstances where "timely procurement of the necessary services could not await prior authorization."

(e)(3) Maximum amounts

The $300 limit contained in the present Act has not been changed since the CJA was enacted in 1964. The proposed bill raises the limit to $1,000, a more realistic figure in view of the increase in fees charged by investigators and experts during the nearly twenty-one years since the current limit was established.

Senator HEINZ. What about the House bill, or the administration's approach?

Mr. WHITTINGTON. I'm not terribly familiar with it, but I know it's very complex, and this is less complex. [Laughter.]

Senator HEINZ. I should quit while I'm ahead.

Mr. WHITTINGTON. We don't have a basic problem with this test.

Senator HEINZ. All right; would any of the rest of you like to comment on the coverage issue?

Mr. WEIZMANN. Senator, as far as H.R. 3838, I think they found that the bill that the coverage rules were so complicated that they proposed they decided they would go back to the drawing board and study it a little further, and as such, I think, in H.R. 3838 it contains a study provision, if you will, on coverage rules.

We, like Shell, don't have many distinctions between hourly and salaried employees—either in our oil-related industry work force or, in fact, in our other subsidiaries that are not in the oil-related business. From time to time, however, we have acquired subsidiaries where there are such distinctions. Oftentimes the continued existence of those subsidiaries as viable economic options, however, are linked very strongly to the benefit costs to be provided by employers.

We find that, in such situations where hourly and salaried plans are in effect and there are differing coverages, that economically it makes sense. It also makes sense from a peculiar standpoint that I don't think is often appreciated. Hourly benefits in noncollectively bargained situations are set basically to be equal to or slightly better than those of comparable hourly workers in collectively bargained situations. Under this bill, and also under the original version of H.R. 3838 proposed, and the original Treasury proposals that, there is an exclusion for collectively bargained plans, but no similar exclusion for noncollectively bargained hourly employees. So what both RIPA and the original proposal under the Tax Reform Act would have required us to do is, in effect, lump hourly employees with salaried employees, and treat two separate classes which on the surface are similar, hourly collectively bargained and hourly noncollectively bargained, dissimilarly. And based on both the economics of the situation and also on the—just anomaly of that point, we find difficulty in accepting the fact that there should not be permissible distinctions between hourly and salaried employees.

Senator HEINZ. How would you address that?

Mr. WEIZMANN. Well, I think what I would look to is basically adequate coverage. Now, by adequate coverage, I mean in two respects. The first respect is that, to make sure that hourly employees are, in fact, covered. I think that certainly RIPA does that, even forgetting about the difference between the salaried and hourly employees.

The second respect, I think what we'd like to do, or what we think is probably an appropriate approach, is to take the minimum benefit under RIPA, perhaps, or some similar type of minimum, meaningful benefit, and use it as the benchmark by which to judge hourly employee plans. A second approach might, in fact, be to look at similarly situated employees in collectively bargained situations and make sure the benefit level, in fact, provides an equal or meaningful level. That said, Senator, it seems to me this is one of those areas where the market will take care of itself. If you provide hourly employees with significantly less in the way of benefits, who are noncollectively bargained today, they will become collectively bargained tomorrow.

Senator HEINZ. Very well. Mr. Rigg.

Mr. RIGG. I'd like to comment on two points. One, I'd like to reinforce the comments relative to using the Social Security wage base as a criterion. Now, we're very much in favor of that. The second point——

Senator HEINZ. Even though you do take a one-time hit?

Mr. RIGG. Yes. We would like to feel that perhaps the law would not change on an "ad-nauseum" basis, and——

Senator HEINZ. I thought Mr. Weizmann provided a very helpful summary of the steady rate of change of the law.

Mr. RIGG. He did. Hence, my comment. [Laughter.]

The other point, though, is the qualification test. We would have some concern if there was no provision for some type of withdrawal, based on our Canadian experience. We would be unable to maintain the 60-percent limit that's in your bill if, in fact, we would revert to the Canadian percentage of 50 percent. So the savings portion, or at least the perceived image of being able to get at the money as we go back to that topic, would be very critical to us.

Senator HEINZ. Yes. Well, that point, I think, has been fairly well made. Are there any other comments?

Mr. GARBER. If I could add one comment on the coverage issue, from our direct experience, we had a—for 80 years did the whole business of the Equitable within the parent company; we have concluded that we will run much better if we establish subsidiary companies which have more independence and ability to run their own affairs. In so doing, the first company that we spun off was an asset-management company, a manager of pension assets, and they carried with them the defined-benefit Equitable plan that had been in the parent company. Thereafter we have acquired a couple of organizations that are in that same business but, in fact, don't have that kind of plan, and, as I recall, don't have a pension plan at all. The philosophy that they came from just did not involve pension plans as part of the compensation.

I would be very concerned if a business test would require either the Equitable to change all of its plans or to take this new entity that comes in with, again, people with their perceptions of what is appropriate compensation and require immediately, then, to institute a pension plan and reduce other compensation or take other steps that would be required. So that, again, it's the perception, and the history becomes important here, and you don't want, the first thing you do when you bring some new group on board is to require them to completely change the way in which they look at the world because that's the way in which the parent company has always carried out their affairs.

Senator HEINZ. All right. Very good.

Well, I want to thank all four of you for coming here today. Your testimony has been very helpful. I thank you.

Would our next group of witnesses please come forward.

APPENDIX 1

COMPARISON OF H.R. 3004 WITH CJA REVISION OF 1984 (CHAPTER XIX OF THE COMPREHENSIVE CRIME CONTROL ACT OF 1984)

Issue	CJA revision of 1984	H.R. 3004
1. Hourly rates	Raised maximum attorney compensation for in-court time to $60 per hour; out-of-court time to $40 per hour.	Would set maximum attorney compensation at $50 per hour for in-court and out-of-court time.
2. Hourly rate variations among districts or circuits.	Did not address	Would permit Judicial Conference to raise maximum attorney compensation to $75 per hour for individual districts or circuits.
3. Subsequent adjustments of hourly rates.	Did not address	Three years after the effective date of the Act, the Judicial Conference would be permitted to raise maximum hourly rate for attorneys up to the cost of living increases for Federal employees.
4. Case compensation maximums	Felony—$2,000; misdemeanor—$800; appeals—$2,000; post-trial motion, probation, subsection (g)—$500.	Felony—$5,000; misdemeanor—$1,500; appeals—$3,000; other cases for which act requires or authorizes appointment of counsel—$1,000.
5. Waiver of maximum amounts	Did not address	Would eliminate requirement that a case must be extended or complex in order for excess compensation to be authorized.
6. Material witness representation	Did not address	Would make appointment of counsel for a material witness in custody mandatory, rather than discretionary, as is provided under subsection (g).
7. Petty offenses where confinement is authorized.	Did not address	Would permit appointment of counsel in petty offense cases where sentence to confinement is authorized and representation is required in the interests of justice.
8. Investigative, expert and other services.	Did not address	Would raise limit for obtaining services without prior authorization to $300. Would raise limit for obtaining services with prior authorization to $1,000. Would permit nunc pro tunc authorization.
9. Malpractice protection for Federal defenders.	Did not address	Would authorize the Director of the Administrative Office to provide professional liability insurance for defenders or provide representation and hold harmless.
10. Training	Did not address	Would authorize funds for continuing education and training of persons providing representational services.
11. Defender organization for the District Court for the District of Columbia.	Did not address	Would remove restriction on District of Columbia Circuit and District of Columbia District Court, thereby allowing the District to establish a Federal defender organization.
12. Certification of witness fees	Did not address	Would amend 28 U.S.C. § 1825 to relieve U.S. attorneys and assistants of the responsibility of certifying payment of defense fact witness fees in Federal criminal cases.

APPENDIX 2

CJA CASE COMPENSATION MAXIMUMS

Type case	Rates (1970–1984)	Present rates (CJA Revision of 1984)[1]	Original Judicial Conference proposal 98th Cong. (H.R. 3233)	(H.R. 3004 99th Cong.) (H.R. 4307 98th Cong.)
Felony	$1,000	$2,000	$10,000	$5,000
Misdemeanor	400	800	3,000	1,500
Appeal	1,000	2,000	6,000	3,000
Post-trial motion; probation revocation; subsection (g)	250	500	[2]2,500	[2]1,000
Expert services without prior authorization	150	150	300	300
With prior authorization	300	300	1,000	1,000

[1] Chapter XIX, of the Comprehensive Crime Control Act of 1984.

[2] In addition to increasing the case compensation levels for felonies, misdemeanors, and appeals, the original Judicial Conference proposal (H.R. 3233, 98th Cong.), H.R. 4307 (98th Cong.) and H.R. 3004 (99th Cong.) would establish a new case compensation category for "any other representation required or authorized" by the CJA. Post-trial motions, probation revocation and subsection (g) representation would be included in this category, as would cases brought within the scope of the CJA under paragraph (a)(5) of the Act, as a result of judicial decisions or new Federal statutes which may require the appointment of counsel. The need for such a provision was most recently demonstrated by the enactment of the Insanity Defense Reform Act of 1984 (Chapter IV of the Comprehensive Crime Control Act of 1984) which amended the CJA to provide for representation at certain mental condition proceedings but failed to include a case compensation maximum for such appointments.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

SECTION 3006A OF TITLE 18, UNITED STATES CODE

§ 3006A. Adequate representation of defendants

(a) Choice of plan

Each United States district court, with the approval of the judicial council of the circuit, shall place in operation throughout the district a plan for furnishing representation for any person financially unable to obtain adequate representation [(1) who is charged with a felony or misdemeanor (other than a petty offense as defined in section 1 of this title) or with juvenile delinquency by the commission of an act which, if committed by an adult, would be such a felony or misdemeanor or with a violation of probation, (2) who is under arrest, when such representation is required by law, (3) who is subject to revocation of parole, in custody as a material witness, or seeking collateral relief, as provided in subsection (g), (4) whose mental condition is the subject of a hearing pursuant to chapter 313 of this title, or (5) for whom the Sixth Amendment to the Constitution requires the appointment of counsel or for whom, in a case in which he faces loss of liberty, any Federal law requires the appointment of counsel. Representation under each plan shall include counsel and investigative, expert, and other services necessary for an adequate defense. Each plan shall include a provision for private attorneys. The plan may include, in addition to a provi-

TESTIMONY OF THE ASSOCIATION OF PRIVATE PENSION AND WELFARE PLANS

Mr. Chairman and members of the Subcommittee, I am G. David Hurd, Executive Vice President of Bankers Life Company, a member of The Principal Financial Group, and appear today as Chair of the Association of Private Pension and Welfare Plans ("APPWP"). The APPWP is a non-profit organization, founded in 1967, with the goal of protecting and fostering the growth of this country's private benefit system. The APPWP's 475 members represent hundreds of plan sponsors as well as leading organizations that support the nation's private employer-sponsored benefit programs: investment firms, banks, insurance companies, accounting firms and actuarial consulting firms. Collectively, APPWP's membership is involved directly with the vast majority of employee benefit plans maintained by American industry.

We commend you, Senator Heinz, and your staff, for your serious efforts to take the long view on national retirement policy. As you well know, employer-sponsored benefit plans are long-range endeavors that have suffered continual modification by Congress through repeated tax law changes. Because these plans primarily benefit rank and file employees, that tinkering damages benefits for the majority of American workers. That needs to stop! Your creative and comprehensive approach to policy objectives will help to move policy-making for the retirement security of our nation's aged out of the annual tax tinkering and into the thoughtful long-view effort you've begun.

Your staff has done an excellent job of drawing various experts from the private sector into the development of this legislation. The ensuing dialogue has helped fashion this bill. As a result, much of the measure is more practical, and therefore preferable to the comparable provisions in the House-passed tax reform bill.

Please consider some educational sessions geographically dispersed throughout the country to explain the bill to plan sponsors and their advisors. We think that this is the best way to widen discussion and get practical input.

We encourage you to continue the joint development of this legislation. Awareness of your bill is beginning to spread more widely among plan sponsors and other benefits professionals. We discussed it at length at the APPWP Board meeting on January 16-17. And tomorrow, I have a meeting with a newly-formed committee of the chairs of our various policy committees to begin deepening our review and study of your efforts, and to then provide more extensive comment than we're ready for today.

Many, many people have testified for years before Congress that benefit programs need relief from annual legislative changes. Your comprehensive bill could accomplish that if two conditions are met:

a. Enough study is put in now so that there are no major flaws in the bill requiring quick revisiting in the next few years. This can be accomplished by being patient enough to continue your joint effort with the private sector over this year to improve the bill.

b. The House tax reform bill is stripped of its retirement provisions.

such adjustments made since the last raise was made under this paragraph. Attorneys shall be reimbursed for expenses reasonably incurred, including the costs of transcripts authorized by the United States magistrate or the court.

(2) Maximum amounts

For representation of a defendant before the United States magistrate or the district court, or both, the compensation to be paid to an attorney or to a bar association or legal aid agency or community defender organization shall not exceed **[**$2,000**]** *$5,000* for each attorney in a case in which one or more felonies are charged, and **[**$800**]** *$1,500* for each attorney in a case in which only misdemeanors are charged. For representation of a defendant in an appellate court, the compensation to be paid to an attorney or to a bar association or legal aid agency or community defender organization shall not exceed **[**$2,000**]** *$3,000* for each attorney in each court. **[**For representation in connection with a post-trial motion made after the entry of judgment or in a probation revocation proceeding or for representation provided under subsection (g) the compensation shall not exceed $500 for each attorney in each proceeding in each court.**]** *For any other representation required or authorized by this section, the compensation shall not exceed $1,000 for each attorney in each proceeding.*

(3) Waiving maximum amounts

Payment in excess of any maximum amount provided in paragraph (2) of this subsection may be made **[**for extended or complex representation**]** whenever the court in which the representation was rendered, or the United States magistrate if the representation was furnished exclusively before him, certifies that the amount of the excess payment is necessary to provide fair compensation and the payment is approved by the chief judge of the circuit.

(4) Filing claims

A separate claim for compensation and reimbursement shall be made to the district court for representation before the United States magistrate and the court, and to each appellate court before which the attorney **[**represented the defendant.**]** *provided representation to the person involved.* Each claim shall be supported by a sworn written statement specifying the time expended, services rendered, and expenses incurred while the case was pending before the United States magistrate and the court, and the compensation and reimbursement applied for or received in the same case from any other source. The court shall fix the compensation and reimbursement to be paid to the attorney or to the bar association or legal aid agency or community defender organization which provided the appointed attorney. In cases where representation is furnished exclusively before a United States magistrate, the claim shall be submitted to him and he shall fix the compensation and reimbursement to be paid. In cases where representation is furnished other than before the United States magistrate, the district court, or an appellate court, claims shall be submitted to the district court which shall fix the compensation and reimbursement to be paid.

* * * * * * *

(e) Services other than counsel

(1) Upon request

Counsel for a person who is financially unable to obtain investigative, expert, or other services necessary for [an adequate defense] *adequate representation* may request them in an ex parte application. Upon finding, after appropriate inquiry in an ex parte proceeding, that the services are necessary and that the person is financially unable to obtain them, the court, or the United States magistrate if the services are required in connection with a matter over which he has jurisdiction, shall authorize counsel to obtain the services.

[(2) Without prior request

[Counsel appointed under this section may obtain, subject to later review, investigative, expert, or other services without prior authorization if necessary for an adequate defense. The total cost of services obtained without prior authorization may not exceed $150 and expenses reasonably incurred.]

(2) Without prior request

(A) Counsel appointed under this section may obtain, subject to later review, investigative, expert, and other services without prior authorization if necessary for adequate representation. Except as provided in subparagraph (B) of this paragraph, the total cost of services obtained without prior authorization may not exceed $300 and expenses reasonably incurred.

(B) The court, or the United States magistrate, if the services were rendered in a case disposed of entirely before the United States magistrate, may, in the interest of justice, and upon the finding that timely procurement of necessary services could not await prior authorization, approve payment for such services after they have been obtained, even if the cost of such services exceeds $300.

(3) Maximum amounts

Compensation to be paid to a person for services rendered by him to a person under this subsection, or to be paid to an organization for services rendered by an employee thereof, shall not exceed [$300,] *$1,000,* exclusive of reimbursement for expenses reasonably incurred, unless payment in excess of that limit is certified by the court, or by the United States magistrate if the services were rendered in connection with a case disposed of entirely before him, as necessary to provided fair compensation for services of an unusual character or duration, and the amount of the excess payment is approved by the chief judge of the circuit.

* * * * * * *

c. Discrimination tests for 401(k) plans. We applaud your approach of using the current law discrimination provisions which seem to be working.

d. Section 415 limits and limits on elective deferrals under Section 401(k) cap. If there must be dollar limits in these areas, and I'll comment more on this issue as I go on, we certainly support your approach of indexing tied to the Social Security wage base as opposed to the unrealistic unindexed limits in HR 3838. But we need much higher dollar figures -- unrealistically low limits on contributions and benefits, first frozen for several years, then indexed, then reduced, can only create uncertainty.

You know better than we that our nation's savings rate and capital formation are lagging. Consider the older couple who has finally gotten through the years of household formation, raising and educating the kids, etc., and have a few years before retirement to lay away pension funds. Low limits impair their ability to have an adequate retirement income. Provisions aimed at increasing taxes on savings are not destined to improve savings. We suggest you look not to income taxes on savings, but to other kinds of taxes to get revenue rather than to Section 415 limits and Section 401(k) caps.

We favor, under Section 415, percentage of compensation limits for (a) defined benefit pensions; (b) employer contributions to defined contribution plans; and (c) elective deferrals under 401(k). We do not favor specified dollar limits. Why not? One of the driving forces (and not by any means the only one) behind new plan formation to benefit rank and file workers, and behind plan improvements to benefit rank and file workers, has been the mix of non-discrimination requirements linked with employer desire to have good benefits proportionally for all workers under qualified plans. Specified dollar limits drive down the level of benefits, as a percentage of compensation, for mid-to-upper income employees within the qualified plan. While non-discrimination rates tend to create an upward pull on rank and file benefits, these low replacement rates for middle-income and upper-income create, over time, a downward drag on those same benefits. We are seeing this today in group life insurance plans due to the archaic $50,000 limit. We would be far better off to specify -- say -- an 85% of pay defined benefit limit including Social Security, a 10% of pay limit on elective deferrals for Section 401(k) plans, etc., with no specified dollar limits. The overall effect would be salutary on rank and file benefits and national savings. We are fooling ourselves if we believe that lowered limits will keep these plans from overbenefitting the higher paid; in the end, they will cause the benefits of the rank and file to deteriorate.

e. The coverage tests. The coverage tests need further study and work. We intend to study these and offer major suggestions. As currently constructed, we fear they will cause serious disruption.

f. Lock-up funds and minimum benefits before an employer can maintain a thrift plan. We applaud your significant effort to provide an intellectual basis for differentiating between retirement plans and savings plans, as well as your efforts to increase pensions paid at retirement. However, more consideration is needed.

More thought is needed about the small, financially-weak employer who has today succumbed to the incentives of adopting a Section 401(k) plan as the firm's first and only retirement plan. That employer is actually making an employer contribution to the plan, contingent on having current year profits. Rules that require an employer contribution in loss years will discourage such employers from maintaining plans at all. And lock-up rules that essentially prevent any withdrawals would be a strong disincentive for the young and low-income employees to sign up. We are concerned. We think more emphasis should be placed on expanding coverage and less on preventing access to funds prior to retirement. We intend to comment on how more might be done in this area through incentives and less by restrictions that could thwart the initial decision to put money away.

g. Portability. This is another area where we think more thought is needed.

h. Effective Date. The effective date in RIPA is one of the most enlightened provisions of the bill. We have just completed massive revisions to plans required by TEFRA, DEFRA and REA. If the tax reform bill passes in its current form, plan sponsors would be faced with another round of equally massive changes in 1986 or perhaps 1987. This is intolerable for all concerned and unhealthy for the future of the private retirement system. A postponed effective date of the magnitude in RIPA would give us all essential breathing room to cope with proposed changes.

The hallmarks of our review of RIPA will be that employer-sponsored plans depend on voluntary action by employers. As the tax incentives are decreased, and the revised rules are made more restrictive and complex, interest in establishing and maintaining plans diminishes. In addition, an important goal is the protection of core benefits such as retirement, health and life insurance. Finally, Congress needs to preserve flexibility both in terms of addressing employees' needs and the employer's ability to provide varying arrangements. We doubt the Congress can better assess what kind of plan an employer should maintain or what level of benefits should be provided. Younger employees saving for retirement need to know that despite their intention to have their funds available at retirement, in the event of unforseen financial emergency prior to retirement, the funds so set aside may be utilized without confiscatory penalty.

We have begun our study of S. 1784 and are accelerating that effort. We will continue to work with your staff in a thoroughly responsible and constructive manner on this important legislation. And again, we applaud your serious and thoughtful effort to deal with the real life, long-range nature of retirement plans.

STATEMENT OF EDWARD O. HANDY, JR., MEMBER , BOARD OF DIRECTORS, THE ERISA INDUSTRY COMMITTEE, AND VICE PRESIDENT FOR EMPLOYEE BENEFITS, TEXTRON INC., PROVIDENCE, RI

Mr. HANDY. Good morning, Senator. My name is Edward Handy. I am vice president of employee benefits at Textron. I am here today on behalf of the ERISA Industry Committee, better known as ERIC.

Senator HEINZ. Mr. Handy, let me just interrupt you on my time for a moment to say that Senator Chafee specifically asked last night that I greet you and welcome you. Textron is a very important constituent organization in Rhode Island. I think he may know you personally. And as I said at the outset, he asked me to tell you that he could not be here because he had to be down to the White House. And I told him I thought you would understand.

Mr. HANDY. I appreciate that, Senator. Was that on your time or was that mine? [Laughter.]

Senator HEINZ. They ran the light on me, not on you there.

Mr. HANDY. I have a number of accolades, but because of the very intense limitations on time I have really cut short on these.

On behalf of ERIC and Textron and myself, there are two objective of the bill that I would like to heartily endorse. The first is that extended coverage is something we all should be seeking. And the other is that our primary objective should be to maintain the pre-retirement standard of living throughout retirement.

I would point out that a half of 1 percent a year accrual plan, even coupled with Social Security, will never accomplish that second objective. There has to be some help from some other source.

And now I would like to turn to my concerns.

First, I think the degradation of savings plans under your bill is something that we should be seriously concerned with. And I would like as a test tube case to talk a little bit about Textron's savings plan. It has been in effect for 25 years. We match every dollar that an employee contributes with 50 cents. We have 20,000 participants. We have $450 million in the plan.

Interestingly enough, we have salaried and hourly folks. Our participation level for the salaried employees is 58 percent: 5.6 percent of compensation is the average contribution rate for the salaried people. Hourly people participate at a rate of 38 percent of the eligibles, and they contribute a higher average, 6.2 percent of their compensation. And, historically, the salaried and hourly folks have contributed about the same percentage of compensation, which suggests that they are squirrels both in the hourly group and in the salaried group.

Attached to our testimony is a schedule of 20 recent retirements picked at random, to indicate that a lot of the savings does flow through to retirement. In fact, the distributions from the savings plan in almost every case are very considerably larger than the lump sum value of the employee's pension.

Now I would like to turn to the coverage questions and make two points. First, I believe our savings plan would be shot out of the water by your bill by the 60-percent participation requirement that

I understand from your floor statement would be applicable. We do not satisfy the 60 percent test. And it seems to me that we will have 20,000 very unhappy people if we take away a plan that has been so meaningful.

Second, comparable benefits give very serious problems to Textron. We are comprised of many different companies with many different unit benifit plans. And you really cannot have a unit benefit plan if it has to be comparable with benefits based on salary. We have 70 or more plans that we would have to completely replace with a brand new kind of pension. This is a troublesome prospect.

A final point, I think, on the bill's distribution rules. You would really have to have complete grandfathering, without seriously breaching of faith with people who have put post-tax moneys aside in a savings plan with the understanding that they could withdraw those moneys for educational purposes, the purchase of a primary or other defined hardships. We must honor the contract people have been living by for 25 years or do a great disservice to the very ones who have made efforts to provide for themselves and meet their own needs.

I come back to my original point. I think it is important that we don't decouple savings plans from retirement plans. The combination is working. Senator Chafee and I have a common friend in Vermont, a farmer named David Brown, who says "When something works, don't fix it."

Senator HEINZ. All right. Mr. Handy, Thank you very much.

John Erlenborn, my esteemed former colleague, somebody who helped celebrate the tenth anniversary of ERISA. We had a little convocation, and I remember Congressman Erlenborn's eloquent presentation on that occasion. You and Jack Javits didn't entirely agree, but then there is nothing new about that.

Mr. ERLENBORN. We agree a lot more now than when we were serving together in the Congress.

Senator HEINZ. John, please proceed. It is nice to have you here. Thank you.

[The prepared written statement of Mr. Handy follows:]

WRITTEN STATEMENT OF EDWARD O. HANDY, JR., THE ERISA INDUSTRY COMMITTEE

Mr. Chairman, I am **Edward O. Handy, Jr.**, Vice President, Employee Benefits for Textron Inc. I am here today to represent **The ERISA Industry Committee** in my capacity as a member of ERIC's Board of Directors.

ERIC appreciates the opportunity to testify on **S. 1784, The Retirement Income Policy Act**, just as we appreciated the chance we were given to review and comment upon early drafts of the legislation. We commend the sponsors of S. 1784 and their dedicated staff members for their diligence and creativity while toiling on an issue that is as complex as it is important.

PART ONE: THE PHILOSOPHY OF RETIREMENT INCOME POLICY

ERIC represents the employee benefit concerns of major private sector employers who sponsor pension and savings plans together covering about ten million workers. These extensive voluntary programs symbolize what is right with current national retirement policy.

Successive Congresses and national administrations have nurtured a tax policy encouraging employers and workers to participate in these plans.

Major private employers accept the responsibility assumed in our national retirement policy to help their employees save for their retirement. Moreover, we are convinced that workers who do not fear for their own or their families' future economic security will perform their jobs better.

Need For Stability

We welcome the recognition by the sponsors of RIPA that any changes in pension law will have a disruptive effect on employer-sponsored plans and the arrangements that workers have made for their retirement security. We applaud their insistence on delayed effective dates.

More than a delayed effective date is necessary, however, if this nation is to make any headway toward RIPA's overall goals of expanded coverage and improved benefits. To achieve those goals, both employers and workers must have stable rules.

Pension programs require long-term funding by employers; workers make long-term plans and commitments based on current law. For the past several years retirement planning has become a moving target at best. Employers and workers alike have faced a bewildering array of cutbacks, new taxes and changed rules justified for a variety of reasons: new revenue, equity, simplicity and what have you. What these changes have created most is uncertainty and instability.

If there is one thing all of our members can agree upon it is that policymakers must resist unnecessary changes. Furthermore, if there is to be any confidence in this system, changes which are made must be made on a truly prospective basis. Specifically, money set aside and benefits funded under current law must be permitted to be distributed under current law.

Only if all sides come into the discussion with that assurance can we truly begin to retain confidence in the system.

Coverage and Benefits

We applaud the emphasis which is placed in the Retirement Income Policy Act in exploring avenues to increase coverage under employer-sponsored plans while keeping in mind the limited resources all employers, large and small, have to expend in this or any other area.

Without the protection of employer-sponsored savings and pension programs, we believe the tragedy of arriving at retirement with insufficient retirement income would again become the national norm.

Since 1940 pension coverage has grown from an almost negligible level to the point today where about 30 percent of all elderly receive pension benefits.

An increasing number of workers are vested and can expect to receive benefits when they retire.

According to Bureau of Labor Statistics data, over 80 percent of employees at medium and large size firms already are covered by a retirement plan.

Among those now retiring, according to the Social Security Administration's 1982 New Beneficiary Study, 56 percent of couples and 42 percent of unmarried persons receive pension income. Experts project that 75 percent of today's younger couples and 65 percent of single persons can expect to receive a pension benefit when they retire. This is despite the fact that the expansion of pension coverage has leveled off in recent years.

Workers not covered under pension plans predominately are younger than age 25, have less than 1000 hours service, or work for smaller businesses. Some others who remain without coverage have marginal attachments to the workforce.

RIPA recognizes that future expansion of coverage under qualified pension plans must come substantially from an expansion of _employee savings_ among employees who work for smaller or less profitable employers. According to the Employee Benefits Research Institute (EBRI), if coverage in firms with fewer than 100 workers were similar to that of slightly larger firms, 7.6 million more workers would be covered under pension plans. These are precisely the employers least likely to be able to fund a plan themselves. We endorse the extension of simplified employee pension coverage proposed by RIPA.

Social security is not designed to be the sole source of support. We expect income from employer-sponsored retirement plans to play an ever more important role in security for retirees. Individual savings, pension income, and Social Security together form the foundation of a retired person's monthly budget.

Three-quarters of the estimated 56 million workers with pension coverage earn less than $25,000 a year. Pension benefits already account for 45 percent of the income of those over age 65 who receive a pension. The 1984 _Economic Report of the President_ and Annual Report of the Council of Economic Advisers summed it up this way:

> Pensions will become a much more important source of retirement income in the future; more and more newly retired workers will have acquired pension rights because of past increases in coverage.

Calculations of pension income often understate the importance of qualified pension and savings plans since they frequently do not account for non-annuity distributions. The additional savings that workers accumulate in non-annuity plans allow workers to meet many needs which enhance financial security in retirement: Among other things, they provide additional income, inflation protection, security against uninsured illness or unexpected obligations, and capital to buy a business to provide additional retirement income. In addition, they provide the opportunity to "catch up" where a worker is able only in mid-career to obtain adequate pension coverage. Thus we would expect in order to provide for the economic security of future retirees Congress would encourage both employer-sponsored pension and savings programs.

We believe pension policy is at a critical juncture. Much of the current debate before this Committee revolves around addressing the federal deficit and seeking to reform our tax laws. We believe, however, that this Committee also bears a direct responsibility to help today's employers and workers provide for tomorrow's retirement.

The Function of Savings Plans

In modern life retirees live independently. They need a retirement income. Money for the retirement must be set aside now.

Private sector plans operate in the worker's environment--questions are answered, concerns are addressed, and benefits are delivered in an environment suited to workers in varying industries, locations and jobs. Decisions about retirement and financial planning for retirement are intensely personal. Thus we strongly support federal policies which give workers the freedom and flexibility they need to save and plan for their own security in retirement.

Here we part company with certain features of the Retirement Income Policy Act. Senator Heinz, as he introduced S. 1784, said:

> I wonder how our retirement income programs, structured the way they are today, will be able to keep pace with the changes now going on in the work force and deliver the benefits this Nation will need in the future.

It is precisely this changing nature of the workforce--its mobility, its demography, and its diversity--that demands the greatest possible flexibility in designing an appropriate retirement income policy. Instead, RIPA points toward a uniform master plan for all Americans, like it or not.

Even though it includes provision for a capital accumulation plan, we believe RIPA fails to recognize the need for capital accumulation as it is encouraged by today's tax code and the role today's savings plans play in retirement security for workers.

From my experience, access to funds for certain well-recognized needs is necessary if we want younger employees to participate. Purchase of a house, educational expenses, uninsured medical expenses are examples. Once the money is in the plan, our experience is that it tends to stay, and the nest egg is prized increasingly as retirement nears.

Access does not mean plunder. I would like to share with the Committee the example of my own company's employee savings plan. In the after-tax part of our savings plan, we allow withdrawal of the employee's own contributions upon presentation of evidence that the employee has encountered one of six categories of hardship. For these withdrawals we do not require proof of immediate heavy financial needs or that funds are not reasonably available from other sources. Yet over the years withdrawals from the plan have been quite limited in number. I have attached here a copy of our after-tax plan hardship withdrawal rules and a matrix of actual withdrawals taken last year **(Attachment A)**.

We also permit hardship withdrawals from 401(k) contributions, but in this case, in keeping with federal regulations, the employee must go to some length to document his or her hardship and we have had few, if any, actual withdrawals of pre-tax contributions. But the potential for withdrawal, in the case of true hardship, is there.

Perhaps some agreement could be reached that non-annuity pre-retirement access to plan savings, be permitted without penalty in cases that involve unanticipated and severe loss of income, extraordinary expense that would jeopardize the individual's future financial security, medical expenses, education expenses and long-term investment such as purchase or construction of primary residence that will generate financial security in retirement.

Some other facts about a real-life savings plan might be of interest. Textron's has been in place since 1960. Employee pre-tax or after-tax contributions are matched by Textron on a 50% basis. Vesting begins after the second year of participation and is 100% after the 5th year. In-service withdrawals have not been permitted, except for hardships, without significant penalty. The plan currently has approximately 20,000 participants and assets of over $450,000,000. In 1984, the last year for which we have complete data, 58% of the eligible salaried employees participated and contributed on the average 5.6% of their base pay, while 37.5% of eligible hourly employees participated and contributed 6.2% of their base pay, a higher rate of contribution than the salaried employees. In recent years the average rates of contribution for hourly and salaried employees have been remarkably consistent, suggesting that there are savers all across the pay spectrum. While we added a 401(k) provision in 1984, after-tax contributions in that year continued at twice the rate of pre-tax we believe largely because of the difference in the hardship withdrawal provisions. Finally, our distributions in the last several years have ranged from $40 to $45 million.

Our experience is that the Textron Savings Plan has played a key role in employees retirement planning and as a source of retirement security. Out of interest, we picked twenty recent retirements for employees who participated in both our pension and savings programs and have compared the value of their pension and savings plan distributions. While not exhaustive, I believe this is a fair sample. The data we found is included as **Attachment** B. I want to emphasize to the Committee that savings plan distributions (which include substantial after-tax employee savings) in most cases are the more valuable and in some cases are much more valuable. This is interesting particularly since our salaried pension plan, a 1- 1/2% step-rate, partially integrated five-year average plan, compares favorably with the pension plans of other major corporate employers. We see our savings plan as a supplemental source of retirement income but also as the retiree's principal cushion against inflation and its erosion of the purchasing power of a pension after retirement.

In short, any legislation which jeopardizes the major role of employer-sponsored thrift programs poses a very clear and present danger to the reasonable expectations and retirement security of thousands of Textron employees and perhaps millions of Americans.

Our objectives are compatible, but we in the private sector need to be able to tailor retirement programs to meet the needs of individual workers in many diverse working environments. Driving workers who face major financial contingencies deeper into debt, or eliminating some of the options they now have to make ends meet, will be a very unpopular decision among workers who participate in these plans. More importantly, such a decision would do little to encourage support for the private sector retirement income system, one of the Retirement Income Policy Act's goals.

Most workers do not maintain separate savings accounts. Nearly a third of all workers covered by a pension plan have little or no savings beyond what they accumulate in their employer-sponsored plans. IRA coverage is concentrated among those who are also covered under employer plans.

In answering questions posed by tax policy, we hope Congress will not neglect equally profound questions that linger beyond the balance sheet. Does the government wish to establish a single formula for the provision of retirement income and a single model of how a worker should use retirement plan savings? Or should government policy continue to encourage diversity, entrepreneurship, even a higher living standard for future retirees? Highly specific standards which leave little room for flexibility are not suitable for a voluntary system and hamper the ability of that system to meet the needs of a large, complex and diverse economy.

We hope that the outcome of this debate will be an approach that provides, as Senator Heinz put it:

> ...a coherent vision of retirement income policy that can help guide tax and pension law changes towards the goal of enhancing retirement income security.

PART TWO: THE RETIREMENT INCOME POLICY ACT PROVISIONS

We have serious concerns about the delegation of savings plans to a secondary role under RIPA. Nevertheless many other portions of this legislation move toward the goal of an effective national retirement income policy, and we offer the following comments in that spirit.

Limits on Contributions and Benefits

RIPA makes some improvements in the security of pension funding over approaches in other proposals such as the House-passed Tax Reform Act (H.R. 3838) or the Bradley-Gephardt tax reform proposal. In RIPA there appears to be a recognition that the Internal Revenue Code Section 415 limits on pension plans contributions as benefits also have an important impact as a funding limit for all benefits expected to be paid in the future.

Wherever the Sec. 415 limits are set, non-qualified plans will be used for select groups to provide adequate replacement of their pre-retirement income. However, when the limits are set below what average workers can reasonably expect to receive in the future because of normal wage growth, and when those limits are repeatedly frozen, then the Congress is simply buying into a national crisis of major proportions.

The final goal acknowledged by the bill's sponsors is to provide retirement income from a variety of sources "...sufficient to maintain an employee's pre-retirement standard of living throughout retirement ...". As employers are forced to get further behind in funding benefits that help meet this target for workers, an increasing portion of employees' retirement income will no longer be protected by the funding, vesting and, perhaps more significantly, the anti-discrimination rules of ERISA.

Thus the effort in RIPA to make indexing of funding limits more secure and more certain, if enacted and maintained, would help preserve confidence in private sector pension plans.

In addition, the elimination of the complex combined plan limits and the establishment of a reasonable, and indexed, limit for 401(k) plan contributions are changes which are consistent with the overall approach of the bill and would be welcome changes from H.R. 3838. We also appreciate the realization that the imposition of an internal cap on 401(k) contributions eliminates any need there may have been to impose a complex new set of nondiscrimination rules on these plans.

However, we strongly urge that the Committee re-examine the impact of changes in limits proposed in RIPA for defined contribution plans, especially where an employer does not have another plan. The low limits for defined contribution plans will prevent employers with such plans from providing adequate retirement benefits to their workers.

Integration

RIPA proposes one simplified approach to pension plan integration. Simplification of this area would be beneficial to the administration and understanding of pension plans. However, we are still examining the specific proposal in S. 1784. In particular we are unclear about the practical impact of the proposal to require that, in offset plans, at least one half of the non-integrated pension benefit be paid. As reported in the January 23, 1985, Washington Post, **(Attachment C)** a Bureau of Labor Statistics' study shows that under the current system the typical combined social security and pension benefit for a long-service, lower income worker in medium and large firms replaces more than 100 percent of final year salary. It appears the proposal in RIPA will exacerbate this situation and may cause other anomalies as well. We would like to work with the Committee further on this as we develop more concrete data.

Five Year Vesting

Five year vesting will have little effect on some companies -- but will have a dramatic effect on others. We do ask the Committee to weigh carefully the additional costs against the actual benefit. We estimate that the cost under our current salaried pension plan would be increased by about 10% if five-year vesting were required. The present value of a five-year pension can be very small and in many cases could be exceeded by related administrative costs. The Committee must recognize the additional costs could in some cases cause a change in plan type, elimination of an existing plan or failure to start up a plan at all.

We would encourage to Committee to examine these questions carefully since we do not believe there are ready or pat answers in this area.

Coverage Requirements

RIPA proposes a simplified, mechanical test for coverage. Although we emphasize we are still examining the proposal, to date we have not encountered substantial problems with the requirement that, in a control group, 80% of ERISA-qualified employees earning wages below the social security wage base should be covered under one of a company's plans. The intent that this requirement be administered on a rolling, multi-year basis adds needed flexibility for unusual situations. We foresee severe problems, however, with the requirement that all plans in a single business division be comparable. We also are concerned that many savings plans may be needlessly scrapped because their participation rates may not be as high as those required in RIPA, even though workers from all wage levels are benefiting from the plan. We object strenuously to the proposal in RIPA to extend for the first time the Internal Revenue Code coverage into ERISA. This would open to multiple courts of common jurisdiction an entirely new area of litigation heretofore resolved by experts in the Internal Revenue Service specifically equipped to deal with the complex issues raised by nondiscrimination rules.

Distribution Rules

We do not endorse and strongly disagree with the RIPA proposals to eliminate 10 year averaging and pre-1974 capital gains, to prohibit any distribution in other than annuity form before age 59-1/2, and to increase the IRA withdrawal penalty to 20 percent.

A federal law mandating life annuities rather than other forms of distribution would reflect a judgment on the part of Congress that adult Americans are incapable of caring for themselves. We suggest that judgment is inappropriate in most cases and reflects a degrading paternalism that prevents workers from meeting their own individual needs.

Averaging is most important to individuals who need to take their retirement savings and use it in a variety of ways. In addition, we would note that the excise taxes proposed here for IRAs and in other legislation concerning early withdrawals from any qualified plan are much more than tax recapture provisions. These penalty taxes are regressive, falling heaviest on those in the lower brackets. According to the Joint Committee on Taxation, an individual in the 25 percent bracket would actually lose money if he or she removed contributions subject to a 20 percent excise tax unless the money had been in the plan for at least 13-1/2 years (assuming a 10% rate of return).

We would favor instead an approach which maintained current distribution rules for IRAs, recognizing that they are a unique vehicle, and, for qualified plans, allowed some form of employee access to their savings, especially to one's own contributions, without penalty.

We also would urge that since the bill allows lump sum distributions (in the case of RIPA, after age 59-1/2) then the means effectively to preserve the value of the distributions, such as 10-year averaging, also be maintained in those cases.

Effective Dates

ERIC endorses the recognition in RIPA that pension planning is an area where immediate effective dates are neither practical nor fair. However, we would strongly encourage you to consider even further delays, especially in some areas. For instance, in fairness to individuals who have already put money aside, and if legislation is enacted which makes changes in the treatment of employee savings, all current accruals should be grandfathered under current rules. If this is not done people, who have been carefully planning for their financial future will be cruelly penalized by Congress, a harsh and strange reward for workers who have tried to help themselves under rules prescribed by Federal law. Other areas, such as changes in vesting or coverage requirements, may require an adjustment period longer than that needed just to amend the plan. In general, the more costly the provision will be to those strongly affected by it, the longer the lead time necessary for smooth and fair transition.

CONCLUSION

This Congress and this Committee are beset with many and varied responsibilities and decisions. No decisions will affect this country or individual working men and women more than those which affect the availability of retirement income. These decisions affect our national savings rate; worker productivity; future demands for public programs; and the living standards of millions of retired workers and families.

We applaud the efforts of the sponsors of the Retirement Income Policy Act to provide a comprehensive approach to retirement policy in our federal laws. We hope the Committee will consider favorably the suggestions we have made.

We are partners in the pension process and we will be pleased to continue to work with this Committee to provide for the current and future retirement security of American workers.

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Attachment A

TEXTRON AFTER-TAX SAVINGS PLAN
HARDSHIP DISTRIBUTION REASON ANALYSIS - 1984

	Education	Divorce	Medical	Income	Home	Judge/Loss	Total
1st Quarter	31	3	6	9	45	4	98
2nd Quarter	34	3	5	5	30	4	81
3rd Quarter	60	6	7	6	50	4	133
4th Quarter	50	9	5	3	41	7	115
	--------	------	------	------	-----	--------	-----
Total	175	21	23	23	166	19	427

TEXTRON SAVINGS PLAN

Hardship Withdrawal Provisions

For purposes of hardship distributions of amounts in your Payroll Contribution account, you must demonstrate to the Committee's satisfaction that a financial need exists because of any of the following:

(a) Expenses or debts incurred or assumed by you and not covered by insurance, arising out of an accident to or the illness or disability of a member of your family, a dependent of yours or yourself, or your divorce or separation, or the divorce, separation or death of a member of your family or a dependent of yours.

(b) Sudden and unexpected losses, not covered by insurance, through casualty, theft or a judgment against you or a member of your family or a dependent of yours.

(c) Expenses of your education or the education of a member of your family or a dependent of yours.

(d) Severe curtailment of your income due to reasons beyond your control.

(e) Expenses incurred in the purchase of or construction in connection with your primary residence.

For purposes of hardship distributions of amounts in your Compensation Deferral account, you must demonstrate to the Committee that a distribution is necessary in light of your immediate and heavy financial needs. Such a distribution is limited to the amount which is required to meet those needs and is not reasonably available from your other resources.

The amount which you may receive will be determined by the Committee after consideration of the extent of your financial need. It cannot exceed your Payroll Contribution account and Compensation Deferral account, as reflected in your statement of account at the close of the preceding quarter.

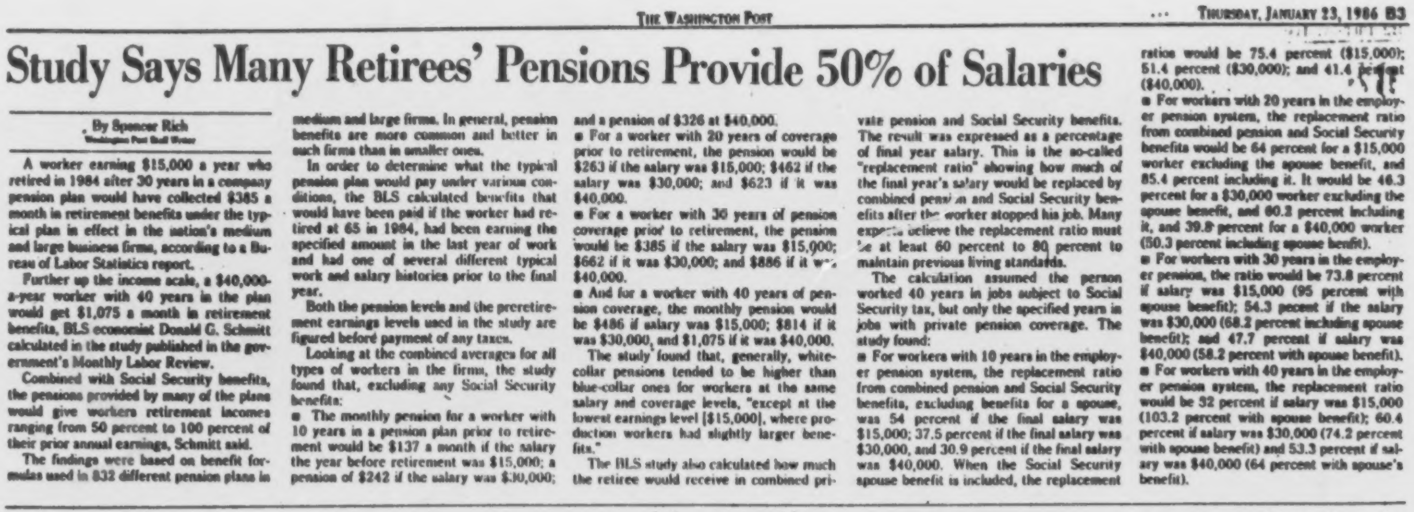
Attachment B

Lump Sum Comparison

TPP vs. TSP - 1985 Sample

Name	Lump Sum TPP	Amount TSP (mv)	Further TSP withdrawal after age 60
A	$ 43,531	$ 38,447	
B	31,133	49,842	
C	47,825	66,563	
D	80,561	300,916	
E	38,170	48,564	
F	73,919	109,566	79,612
G	5,183	16,271	
H	26,905	114,115	
I	195,730	153,680	
J	22,710	5,189	2,513
K	78,618	133,178	38,081
L	132,209	33,122	
M	5,741	9,958	
N	14,884	5,911	
O	78,186	26,572	
P	61,848	237,495	
Q	19,209	36,824	
R	72,071	233,075	
S	105,643	107,352	40,518
T	12,995	15,163	

Attachment C



The Washington Post ••• Thursday, January 23, 1986 B3

Study Says Many Retirees' Pensions Provide 50% of Salaries

By Spencer Rich
Washington Post Staff Writer

A worker earning $15,000 a year who retired in 1984 after 30 years in a company pension plan would have collected $385 a month in retirement benefits under the typical plan in effect in the nation's medium and large business firms, according to a Bureau of Labor Statistics report.

Further up the income scale, a $40,000-a-year worker with 40 years in the plan would get $1,075 a month in retirement benefits, BLS economist Donald G. Schmitt calculated in the study published in the government's Monthly Labor Review.

Combined with Social Security benefits, the pensions provided by many of the plans would give workers retirement incomes ranging from 50 percent to 100 percent of their prior annual earnings, Schmitt said.

The findings were based on benefit formulas used in 832 different pension plans in medium and large firms. In general, pension benefits are more common and better in such firms than in smaller ones.

In order to determine what the typical pension plan would pay under various conditions, the BLS calculated benefits that would have been paid if the worker had retired at 65 in 1984, had been earning the specified amount in the last year of work and had one of several different typical work and salary histories prior to the final year.

Both the pension levels and the preretirement earnings levels used in the study are figured before payment of any taxes.

Looking at the combined averages for all types of workers in the firms, the study found that, excluding any Social Security benefits:

- The monthly pension for a worker with 10 years in a pension plan prior to retirement would be $137 a month if the salary the year before retirement was $15,000; a pension of $242 if the salary was $30,000; and a pension of $326 at $40,000.
- For a worker with 20 years of coverage prior to retirement, the pension would be $263 if the salary was $15,000; $462 if the salary was $30,000; and $623 if it was $40,000.
- For a worker with 30 years of pension coverage prior to retirement, the pension would be $385 if the salary was $15,000; $662 if it was $30,000; and $886 if it was $40,000.
- And for a worker with 40 years of pension coverage, the monthly pension would be $486 if salary was $15,000; $814 if it was $30,000, and $1,075 if it was $40,000.

The study found that, generally, white-collar pensions tended to be higher than blue-collar ones for workers at the same salary and coverage levels, "except at the lowest earnings level [$15,000], where production workers had slightly larger benefits."

The BLS study also calculated how much the retiree would receive in combined private pension and Social Security benefits. The result was expressed as a percentage of final year salary. This is the so-called "replacement ratio" showing how much of the final year's salary would be replaced by combined pension and Social Security benefits after the worker stopped his job. Many experts believe the replacement ratio must be at least 60 percent to 80 percent to maintain previous living standards.

The calculation assumed the person worked 40 years in jobs subject to Social Security tax, but only the specified years in jobs with private pension coverage. The study found:

- For workers with 10 years in the employer pension system, the replacement ratio from combined pension and Social Security benefits, excluding benefits for a spouse, was 54 percent if the final salary was $15,000; 37.5 percent if the final salary was $30,000, and 30.9 percent if the final salary was $40,000. When the Social Security spouse benefit is included, the replacement ratios would be 75.4 percent ($15,000); 51.4 percent ($30,000); and 41.4 percent ($40,000).
- For workers with 20 years in the employer pension system, the replacement ratio from combined pension and Social Security benefits would be 64 percent for a $15,000 worker excluding the spouse benefit, and 85.4 percent including it. It would be 46.3 percent for a $30,000 worker excluding the spouse benefit, and 60.2 percent including it, and 39.8 percent for a $40,000 worker (50.3 percent including spouse benefit).
- For workers with 30 years in the employer pension, the ratio would be 73.8 percent if salary was $15,000 (95 percent with spouse benefit); 54.3 pecent if the salary was $30,000 (68.2 percent including spouse benefit); and 47.7 percent if salary was $40,000 (58.2 percent with spouse benefit).
- For workers with 40 years in the employer pension system, the replacement ratio would be 32 percent if salary was $15,000 (103.2 percent with spouse benefit); 60.4 percent if salary was $30,000 (74.2 percent with spouse benefit) and 53.3 percent if salary was $40,000 (64 percent with spouse's benefit).

STATEMENT OF JOHN N. ERLENBORN, SEYFARTH, SHAW, FAIRWEATHER & GERALDSON, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, WASHINGTON, DC

Mr. ERLENBORN. Thank you very much, Senator. I am pleased to appear here today on behalf of the U.S. Chamber of Commerce.

I am the chairman of the Chamber's Task Force on Retirement Insurance Policy. The Chamber applauds you and Senator Chafee for undertaking a comprehensive analysis of retirement policy which is evidenced by the introduction of the Retirement Income Policy Act, S. 1784, and the convening of this hearing.

The Chamber totally agrees with the major goals of that bill, expanding privately sponsored pension coverage and enhancing retirement security. We do have some concerns which are expressed in this statement with the way the bill seeks to meet these goals.

With numerous pension provisions contained in the House-passed tax measure, that bill and a study of retirement income policy are inevitably related. We believe, however, that the objective of a sensible and stable retirement policy is far better served by a deliberate and unhurried analysis of retirement needs which S. 1784 seeks to initiate.

Accordingly, we urge this committee in the strongest terms possible not to adopt the pension provisions of H.R. 3838 and not to modify current pension laws as part of any tax reform bill that it may draft in the coming weeks.

If Congress should determine that there is a national need to strengthen some component of the three-legged stool, it may be able to accomplish this objective through fine tuning rather than through enacting a comprehensive revision of retirement policy and the laws that embody that policy.

According to the Small Business Administration, 86 percent of firms with over 500 employees offered pension plans to their employees in 1983, while only 19 percent of firms with fewer than 25 employees did so.

First, small firms frequently lack stable profits to establish and fund pension plans. Second, pension plans—specifically, defined benefit plans—can be enormously costly and complex to administer.

The Small Business Administration reports that it costs smaller firms—those with fewer than 10 employees—about twice as much per employee to operate a defined benefit plan as it does for large companies with over 500 workers.

Each time tax and labor laws affecting pensions are enacted, small companies must devote a disproportionate share of their resources to comply with the new law.

For those companies without pension plans continual legislative changes force them to stand on the side lines wondering whether the rush of pension legislation will abate long enough to let them establish affordable plans in a climate of predictability.

The Chamber appreciates the phased in effective date of S. 1784, which is responsive to the business community's concern about everchanging pension laws.

But the provisions of S. 1784 likely will not resolve the root causes of the coverage problem. Changing the percentages of employees below the Social Security wage base who must be covered by a pension plan or denying tax favored treatment for employee contributions to plans deemed to be nonretirement will not increase substantially retirement plan coverage.

It should be noted that the same problem is raised in part of the House tax bill, the so-called nondiscrimination rules. That bill will have a negative impact on the continuation and creation of small plans.

Pension plan sponsors are accountable to a host of Federal Government agencies. The repeated onslaught of new laws affecting retirement plans has put the regulatory agencies years behind in issuing guidelines and rules. In this atmosphere, employers are at a loss as to how best to comply with the law.

Any complete effort to expand pension coverage must include resisting the enactment of new statutes and regulations and a sincere effort to dismantle obstacles.

Growth of defined contribution plans holds forth the best opportunity to close the pension coverage gap.

At this point, Senator, would it be proper to ask unanimous consent to proceed for another 5 minutes as we do in the House? [Laughter.]

Senator HEINZ. I will compromise. [Laughter.]

Mr. ERLENBORN. I will finish up very shortly.

We note that both S. 1784 and the House tax measure seek to restrict the opportunity for employees to receive money from plans before retirement, especially if the distribution is in a lump sum. We fear that that restriction will discourage many people from participating.

We note with consternation that the House tax bill would prohibit 401(k) plans for employees of tax exempt organizations, except those meeting a specified retroactive grandfather provision. This result is contrary to a basic tenant of tax reform fairness.

Another major feature of S. 1784 is its requirement that the period an employer could require an employee to work before vesting in a pension plan be reduced from 10 to 5 years. In that regard, we fear that pension plans may be turned into severance pay plans by providing small benefits cashed out after 5 years of working and separation from service and then used for current spending rather than for pension benefits.

Mr. Chairman, I won't take any more time, but let me say that we have made other points in our statement, and I hope that the entire statement will be included in the record and that you and your staff will read it.

Senator HEINZ. John, without objection, all the statements of all the witnesses in their entirety will be a part of the record. And we do thank all witnesses for summarizing their testimony. So without objection, so ordered.

Mr. Holan?

[The prepared written statement of Mr. Erlenborn follows:]

STATEMENT
on
RETIREMENT INCOME POLICY
before the
SENATE COMMITTEE ON FINANCE
for the
U.S. Chamber of Commerce
by
John N. Erlenborn
January 28, 1986

Mr. Chairman and members of the Committee, my name is John N. Erlenborn. I am a partner in the law firm of Seyfarth, Shaw, Fairweather & Geraldson. I am pleased to appear here today on behalf of the U.S. Chamber of Commerce, the world's largest federation of businesses, chambers of commerce, and trade and professional associations. Accompanying me is James A. Klein, Manager of Pension and Employee Benefits for the Chamber.

I serve on the Chamber's Labor and Employee Benefits Committee and on several of that committee's councils and task forces that develop policy on labor and employee benefits matters. I am Chairman of the Chamber's Task Force on Retirement Income Policy.

During my twenty years in Congress, no single subject occupied more of my time than pension law and related matters. I hope my remarks today, drawing upon my perspectives both inside the Congress and inside the private sector, will assist you in this important inquiry into retirement policy.

The Chamber applauds Senators Heinz and Chafee for undertaking a comprehensive analysis of retirement policy, which is evidenced by the introduction of the Retirement Income Policy Act, S. 1784, and the convening of this hearing.

The Chamber totally agrees with the major goals of that bill, i.e., expanding privately sponsored pension coverage and enhancing retirement security. We do have some concerns, which are expressed in this statement, with the way the bill seeks to meet those goals. We hope the Chamber's comments today and in the future will assist you during any further consideration of S. 1784.

The timing of this hearing could not be more propitious, in view of the major effort this committee is about to undertake with regard to tax reform. With numerous pension provisions contained in the House-passed tax measure, H.R. 3838, that bill and a study of retirement income policy are inevitably related. We believe, however, that the objective of a sensible and stable retirement policy is far better served by a deliberate and unhurried analysis of retirement needs which S. 1784 seeks to initiate. Accordingly, we urge this committee, in the strongest terms possible, not to adopt the pension provisions of H.R. 3838 and not to modify current pension law as part of any tax reform bill that it may draft in the coming weeks.

I. THE IMPORTANCE OF PRIVATE RETIREMENT PLANS

The central theme of the Chamber's view of retirement policy is belief in and support for the so-called three-legged stool of retirement security. These legs include (1) Social Security, which provides the foundation for income protection upon which other forms of income are built; (2) employer-sponsored pension plans, which may include both defined benefit plans (in which the employer promises and pays a fixed benefit) and defined contribution plans (in which the employer and/or employee contribution is established and the ultimate benefit paid depends on the growth of the particular plan); and (3) personal savings.

The tax laws have been a principal inducement for employers to initiate and maintain pension plans. Personal savings have been encouraged through the tax laws as well, with favorable tax treatment afforded to employer-sponsored savings plans and, more recently, the creation and expansion of individual retirement accounts (IRAs). Thus, it can be seen that although there has been no formal adoption of a policy statement, a national retirement income policy has been formulated implicitly and recognized in the structuring of the present system through various legislative enactments.

In light of this extensive and interrelated retirement income structure, if Congress should determine that there is a national need to strengthen some component of the three-legged stool, it may be able to accomplish that objective through fine-tuning rather than through enacting of a comprehensive revision of retirement policy and the laws that embody that policy.

II. PENSION COVERAGE

The origin of S. 1784 is the recognition that private pension coverage is far from universal. Of course, this nation has made great strides in providing private pensions. The Employee Benefit Research Institute (EBRI) reports that in 1962 only 16% of all married couples received a private employer-sponsored pension. By 1982 this figure had more than doubled to 33%.

Overall, EBRI reports that 52% of the work force is covered by a pension. The Chamber's own employee benefits survey, which has been conducted continuously since the 1950's and which surveys all forms of benefits, found that 83% of companies responding to the survey in 1983 had pension plans. Whatever measure is used, we all acknowledge that private pension coverage is not as extensive as it should be — especially among small businesses. This greatly concerns the Chamber because the failure to expand coverage adequately puts greater pressure on private savings and, especially, on the Social Security system to do the whole job in providing retirement income -- a purpose for which the Social Security system simply was not designed.

A. Small Business Concerns

The Small Business Administration (SBA) has gathered compelling evidence of the depth of the pension coverage problem for small businesses. According to the SBA, 86% of firms with over 500 employees offered pension plans to their employees in 1983, while only 19% of firms with fewer than 25 employees did so.

To expand pension coverage for small firms, understanding the obstacles that small firms confront is vital. First, small firms frequently lack stable profits to establish and fund pension plans. Second, pension plans, especially defined benefit plans, can be enormously costly and complex to administer. SBA reports that it costs smaller firms (those with fewer than 10 employees) about twice as much per employee to operate a defined benefit plan as it does for large companies with over 500 workers.

Moreover, each time tax and labor laws affecting pensions are enacted, small companies must devote a disproportionate share of their resources to comply with the new law. For those companies with retirement plans, the Tax

Equity and Fiscal Responsibility Act (TEFRA), the Deficit Reduction Act (DEFRA), and the Retirement Equity Act (REA) have established new standards to meet. Compliance is especially troublesome for small firms. For those companies without pension plans, continual legislative changes force them to stand on the sidelines, wondering whether the rush of pension legislation will abate long enough to let them establish affordable plans in a climate of predictability.

The Chamber appreciates the phased-in effective date of S. 1784, which is responsive to the business community's concern about ever-changing pension laws. Likewise, the provision of the bill to permit employees to make tax-free contributions to a simplified employer pension plan may be a positive step toward encouraging pension coverage for employees of small businesses. But the provisions of S. 1784 likely will not resolve the root causes of the coverage problem. Changing the percentages of employees below the Social Security wage base who must be covered by a pension plan or denying tax-favored treatment for employee contributions to plans deemed to be "non-retirement" will not increase substantially retirement plan coverage. Rather, for employers without plans, a new set of rules only will serve as a disincentive to establish them.

Parenthetically, it should be noted that the same problem is raised as part of the House tax bill, H.R. 3838. The so-called "nondiscrimination rules" in that bill will have a negative impact on the continuation and creation of pension plans. For those employers with plans, a new set of rules may, at best, be an administrative burden and, at worst, an incentive to abandon the plans. For employers without retirement plans, new restrictive rules will be a disincentive to establish them.

B. Expanding Coverage

EBRI calculates that if coverage in firms with fewer than 100 workers were similar to that of larger firms, approximately 7.6 million more workers would be covered. In light of this, we need to determine how best to encourage this expanded coverage. Clearly, reducing regulatory burdens for operating all plans and providing incentives for establishment of new plans — especially defined contribution plans — are two important ways.

C. Regulatory Relief

Ensuring the financial stability of retirement plans and the fairness with which they are offered to employees is sound national policy. The Chamber supports that policy. But, as in so many other areas of the law, a plethora of statutes and regulations stifles the ability of employers to meet the objective of broader and more generous retirement income. Pension plan sponsors are accountable to a host of federal government agencies, most notably the Department of Treasury, the Internal Revenue Service, the Department of Labor, and the Pension Benefit Guaranty Corporation. Regulations for defined benefit plans are particularly onerous. The repeated onslaught of new laws affecting retirement plans has put the regulatory agencies years behind in issuing guidelines and rules. In this atmosphere, employers are at a loss as to how best to comply with the law.

The legislative and regulatory confusion is not just an employer concern. It is a serious problem for workers. For employers without plans, the legislative/regulatory environment sends just one clear message: "stay away." For companies with plans, valuable dollars that could be spent to provide higher benefits are diverted to attorneys, actuaries, accountants and consultants who themselves are struggling to keep pension plan sponsors in compliance with the law.

One message from the Chamber should be clear. Any complete effort to expand pension coverage must include (1) resisting the enactment of a spate of new statutes and regulations and (2) a sincere effort to dismantle obstacles to employers' ability to establish and continue pension plans.

D. Defined Contribution Plans and Employee Needs

Growth of defined contribution plans holds forth the best opportunity to close the pension coverage gap. These plans are more popular among smaller companies because they are simpler and less costly to operate. SBA data shows that in firms with fewer than 100 employees, 70% of workers covered by retirement plans are covered by only a defined contribution plan, compared to just 7% of covered workers in firms with 100 or more workers.

However, despite their ability to help close the pension gap, defined contribution plans have been criticized because many such plans permit access to the funds prior to reaching retirement age.

We note that both S. 1784 and the House tax measure seek to restrict the opportunity for employees to receive money from plans before retirement, especially if the distribution is in a lump sum. The Chamber urges Congress to consider the disincentives for participation in defined contribution plans that will occur if employee options are limited. Without access to funds prior to retirement, if necessary, employees will be more reluctant to participate in plans. One of the primary features of 401(k) and many other defined contribution plans is the opportunity for employee contributions. If employees' access to their own money is prohibited, the very people with the greatest need for retirement plans and those with the fewest alternatives to personal savings (i.e. lower- and middle-income workers) will be dissuaded from participating. We urge Congress not to thwart retirement security goals by limiting employees' choices and employers' opportunities to establish retirement income vehicles.

E. 401(k) Plans for Tax-Exempt Organizations

The Chamber encourages this committee to improve private plan coverage by ensuring that retirement plans are as broadly available as possible. We note with some consternation that the House tax bill would prohibit 401(k) plans for employees of all tax-exempt organizations (except those meeting a specified retroactive grandfather provision). This result is contrary to a basic tenet of tax reform -- fairness. Morever, it ought to concern everyone interested in a logical retirement income policy, because it takes away from one segment of the private sector a very valuable retirement plan. Tax-exempt entities, by their very nature, have fewer resources to devote to defined benefit plans, and 401(k) plans have helped them to provide retirement income protection to their employees. They, like everyone else, should be permitted to keep existing or to establish new 401(k) plans.

III. PENSION VESTING

Another major feature of S. 1784 is its requirement that the period an employer could require an employee to work before vesting in a pension plan be reduced from 10 to five years.

We do not doubt that this change would increase the number of people who actually would vest in a pension plan and receive benefits. We also do not doubt that as soon as the vesting period would be reduced from 10 to five years, there would be those who would call for one year or even immediate vesting. If, as demographic factors change and as work force mobility expands, too many individuals are not meeting vesting requirements, American businesses will discover that they need to relax vesting standards in order to remain competitive in recruiting and keeping talented employees. This likely may become more apparent to businesses in the coming years, when we can expect to face a labor shortage for many types of jobs. And, of course, employers have the option to reduce vesting periods without changes in the law.

However, mandating faster vesting does present some probelms. First, the benefits vested as a result of relatively short periods of service are not substantial. The only advantage of the shorter vesting period is to an employee who separates from service after early vesting and before the current longer vesting period. With employee benefits already accounting for 36.6% of payroll, according to the Chamber's 1983 Employee Benefits Survey, and with pension costs a significant employer expense, mandating faster vesting would necessitate lower future benefits in order to keep overall pension costs stable. Hence, the value of faster vesting for some employees might be offset by lower ultimate pension benefits for all retirees. And lower pension benefits translate into greater reliance on Social Security to meet retirement needs.

Second, such minimal benefits typically are paid in a lump sum at the time of separation from service and usually are used for current expenditures rather than for retirement purposes. Therefore, early vesting might tend to transform the pension plan for these employees into a severance pay plan. Alternatively, faster vesting might create a different type of difficulty in employment relationships for employers and their young employees. Accelerated vesting could mean, for example, that a worker hired at age 20 who leaves a company's employ at age 25 would be entitled to a pension benefit payable starting some 40 years in the future. Asking employers to continue that relationship with former employees for several decades is onerous. While this already happens to some degree today, it would be exacerbated with the number of employees who stay with an employer for just a few years at the beginning of their working life.

Fortunately, we can take steps to ensure that more retirees receive pension benefits, without requiring faster vesting. First, greater growth of defined contribution plans will foster more vesting, because employers are less concerned about earlier vesting when they do not have to bear the risk of paying a lifetime of promised benefits to a person who was only briefly on their payroll. Of course, employees always are vested immediately in their own contributions, so the growth of employee-funded plans also will help to meet retirement income objectives.

Second, Congress can explore further the question of pension portability. If employees could have more ability to "take their pensions with them" as they moved throughout the work force, the matter of vesting in a company's plan would be less of an issue. Accordingly, we hope that Congress will look more closely at proposals, such as the "Retirement USA" bill, H.R. 3098, sponsored by Representative James M. Jeffords. The Chamber currently is studying this measure as one possible approach to increasing pension availability.

Finally, we believe that retaining 10-year vesting for multiemployer plans while requiring five year vesting for single employer plans is ill-advised. Such a disparity would skew employer decision making about the type of plan with which to be involved and would disadvantage many non-unionized companies with single employer plans that compete with unionized companies that participate in multiemployer plans.

IV. CONTRIBUTION AND BENEFIT LIMITS

The Chamber commends Senators Heinz and Chafee for noting, in the remarks accompanying the introduction of S. 1784, that realistic contribution and benefit limits — Internal Revenue Code Section 415 limits — are essential in order for pension plans to provide meaningful income. It also is crucial to maintain sufficiently high limits so that employers are not encouraged to abandon their tax-qualified plans and instead establish non-qualified plans (which are not bound by restrictive limits, but which also do not afford the same employee protections). That would undermine the very purpose of the 1974 Employee Retirement Income Security Act (ERISA).

The Section 415 limits have been reduced statutorily in recent years, even though we should expect higher limits to be necessary to ensure adequate funding for payment of pension benefits. Currently, the benefits funded under a defined benefit plan cannot exceed the lesser of 100% of compensation or $90,000. For defined contribution plans, contributions cannot exceed the lesser of 25% of compensation or $30,000.

Linking the Section 415 limits with the Social Security wage base, as called for in S. 1784, has the advantage of introducing an element of predictability where Congressional action in the past has both reduced these limits and frozen them for periods. The formula selected in S. 1784 initially would raise slightly the limits for defined benefit plans and lower the limits for defined contribution plans.

Converting from a three to one benefit/contribution dollar ratio to a four to one ratio, as the bill envisions, appears to tilt the balance in favor of defined benefit plans, although the stated intent of the bill is to remain neutral with regard to this choice. As previously mentioned, with defined contribution plans offering the best opportunity to fill the private pension gap among small businesses, Congress should be wary of any policy change that makes such plans less attractive.

The Chamber has similar concerns about Section 415 limits in H.R. 3838, the House-passed tax bill. Proposed lowered limits will make it increasingly difficult for companies to meet the funding standards needed in the future to pay benefits to even middle-income workers. This committee carefully should scrutinize the adverse impact on retirement income security of lowered Section 415 limits. In the same vein, reduced contribution levels specifically for 401(k) plans, as called for in H.R. 3838, will hamper the ability of these plans to play a role in retirement security.

The Chamber notes that the sponsors of S. 1784 have recognized problems with "top-heavy" rules that plague small businesses. Although the bill does not propose immediately to change or repeal these rules, it is a positive development that the sponsors acknowlege that Congress has created a series of rules that, along with being designed to protect employees, hinder the establishment of plans in the small-business sector.

V. PENSION DISTRIBUTIONS

We already have addressed some of the issues regarding plan distributions in the context of our earlier comments about defined contribution plans and employee needs for access to funds. We recognize that lawmakers want to ensure that retirement funds are being used for retirement purposes. Accordingly, the central theme of S. 1784 is to draw a distinction between retirement and nonretirement plans, with the essential difference between the two being benefit distribution and tax treatment of elective employee contributions.

As a former member of Congress, I especially can empathize with the difficult task lawmakers have in deciding upon the proper age below which distributions of pension assets should not be encouraged as a matter of public policy. However, before this committee accepts the view that pension distributions prior to age 59 1/2 are not to be permitted, and that stream-of-income payments are always preferable to lump-sum payments, I encourage you to consider the need for flexibility in retirement planning. We are a nation of 90 million working Americans. We each have different needs and define our retirement goals in somewhat different ways. Although we obviously cannot have 90 million different pension rules, we should have rules that recognize various ways of fulfilling retirement needs. Limiting pension income choices should be avoided. Restricting lump-sum distributions and repealing 10-year forward tax averaging, as both S. 1784 and the House tax bill would do, does eliminate some choices for retirees whose retirement income needs would be served legitimately by the use of a lump-sum payment. Often lump sum payments are used for the purchase of a retirement home or for making investments that can bolster retirement income. In addition, changing the rules on 10-year averaging interrupts the retirement income plans that some older workers already have contemplated.

Finally, restricting early employee access to pension assets, as S. 1784 seeks to do, could discourage employees from making voluntary contributions to retirement plans for fear that if an emergency were to arise, the employees' own money would not be reachable.

Various types of distribution restrictions raise important questions, and an important factor in addressing these questions is the need for employee/employer flexibility in designing retirement plans.

VI. CONCLUSION

Strengthening the private retirement system is and ought to be a national priority. It presents enormously complex and, in many instances, non-tax issues that cannot be dealt with adequately in the context the tax reform effort. Any consideration of methods to expand pension coverage, either legislative or administrative, should be examined carefully against the backdrop of our already very comprehensive national retirement policy -- the three-legged stool concept. Moreover, meeting retirement income goals necessitates making it possible and attractive for employers to sponsor private pension plans. It is in this way that adequate income security for all retired Americans can be ensured.

STATEMENT OF WALTER HOLAN, PRESIDENT, PROFIT SHARING COUNCIL OF AMERICA, CHICAGO, IL

Mr. HOLAN. Thank you, Senator.

With this limited time, take the accolade as given. S. 1784 would have a drastic adverse effect, however, on many profit sharing plans. [Laughter.]

In such profit sharing plans contributions are made on the basis of profits. Our last two annual surveys showed that about 8 percent of our members made no contribution to their profit sharing plans because of a lack of profits. About 55 percent of our member plans also allow for voluntary employee savings to build up additional retirement income. To encourage such savings, these plans permit loans and withdrawals. If an employer wishes to continue these voluntary employee savings bill under these conditions, the bill requires that profit sharing employers must contribute at least 3 percent of profits yearly. If the employer also wishes to maintain the ability to contribute on the basis of profits, employers will be faced with one of two options, either drop the voluntary savings feature or keep it in place under the pay out restrictions of the bill.

If the first option is selected it will reduce the amount of retirement income available to participants. If the latter choice is made it will discourage employees from making such contributions, particularly young employees.

I might point out that a dollar invested at 20 and retained until 65 has a much greater value than a dollar put in at a later age such as 45.

Traditionally, profit sharing pay outs have been made primarily in lump sum distributions, either in cash or employer's itock. And this pay out has served well the needs of retirees to plan for their retirement. Lower or middle income employees frequently take lump sums, and use part of this distribution to pay off the mortgage on their home, move to a more favorable climate and purchase a retirement home, or use the funds for costly medical needs. They then reinvest the balance in secure investments which keep pace with inflation.

Participants who receive employer stock at retirement would be particularly harmed by the elimination of 10-year averaging and capital gain treatment and unrealized appreciation.

Those who object to allowing participants to receive a lump sum seem to have no confidence in the ability of the American worker to handle his or her own funds in retirement. To paraphrase Coach Mike Ditka, this seems to be a case of the Smiths telling the Grabowskis they don't know how to handle their money.

In the council's many years of experience a great majority of participants in profit sharing plans want and take lump sum distributions. And we have never heard of one incident in which a lump sum distribution, accumulated over many years, has been squandered by a participant. If such events were to occur, I am sure that Council members would see to it that profit sharing payments are made on an installment basis since they, too, are equally concerned with the needs of their retiring employees.

The reduction in the 415 limits was previously discussed and I might add that judging from what I have seen—and I am not a statistician—the 1974 limits imposed under ERISA are worth about $6,000 in this bill.

This bill emphasizes retirement only. You must remember that profit sharing is also an incentive system and a productivity booster. When employees become profit conscious, friction eases, production spurts, costs drop and profits rise. Profit sharing promotes and systains morale, interest, and allegiance and loyalty on the part of the employees.

These factors should be kept in mind when considering legislation affecting such plans. Too much of the emphasis we see is geared to the retirement aspects without consideration of the contribution of profit sharing to the economic well-being of the Nation.

We believe that the unique benefits derived from profit sharing should not be sacrificed to patronizing zeal in protecting the employees by prescribing still another uniformed annuity system and restricting the ability of the American worker to handle his or her own money in the way he or she determines suitable.

Thank you, Mr. Chairman.

Senator HEINZ. Mr. Holan, thank you for a very succinct statement.

Mr. Silver.

[The prepared written statement of Mr. Holan follows:]

STATEMENT OF WALTER HOLAN, PRESIDENT, PROFIT SHARING COUNCIL OF AMERICA, ON RETIREMENT INCOME POLICY ACT

**PROFIT Sharing Council
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The Profit Sharing Council of America (PSCA) is a non-profit association of approximately 1,300 employers who maintain profit sharing plans. These plans cover approximately 1,750,000 employees. Council members are located throughout the United States and are engaged in practically all areas of economic activity. Member companies range in size from Fortune 500 size companies down to very small businesses.

Some of the material presented in this statement comes from the Profit Sharing Research Foundation (PSRF), Evanston IL, a non-profit publicly supported research and educational foundation.

Profit sharing is an incentive system and productivity booster whose design, application and approach differ according to the needs and problems of individual firms. When employees become profit conscious friction eases, production spurts, costs drop and profits rise. Profit sharing promotes and sustains morale, interest, allegiance and loyalty on the part of employees. When management intelligently shares profits the company prospers, the stockholders prosper, the employees prosper and the nation prospers. These factors should be kept in mind when considering legislation affecting such plans. Much of the emphasis we see today is geared to the retirement aspect of profit sharing alone, without due consideration of its contribution to the economic well-being of the nation.

Deferred profit sharing plans are or will be the primary private source of exceptional retirement benefits for millions of retirees and employees whose efforts during their working lifetimes contribute to the success of thousands of U.S. companies which elect to share their profits with their employees. There are approximately 360,000 deferred profit sharing plans in existence. These plans cover approximately 20 million employees and we estimate these plans have assets of well over $175 billion.

Profit sharing plans are usually established with one or more of the following objectives:

- to provide retirement income;
- to deliver benefits in the event of disability, death or employment termination prior to retirement;
- to create an incentive for increasing productivity and decreasing costs;
- to accumulate savings for employees, which contribute to capital formation; and
- to attract and reward employees by sharing the profits of the free enterprise system broadly throughout the organization.

Deferred profit sharing plans provide participating employees with special sums of money placed in trust, in addition to their pay at prevailing rates. These extra payments are based on the profits of the employer and generally average 8% to 10% of payroll, but can range up to 15%. In recent years employee savings in plans have dramatically increased through voluntary and mandatory employee contributions and through cash or deferred arrangements under Section 401(k).

A large majority of plans offer options to participants as to how and when their accumulated profit sharing accounts are distributed at retirement. Generally the account is distributed in a lump sum. Many plans also allow the retirees to receive their account balances in annual installments or the plan may purchase and distribute an annuity contract. If the participant dies while employed, the full account balance is distributed to the designated beneficiaries, regardless of service requirements for vesting. Some plans permit partial withdrawals or loans during employment, in hardship situations. Plans usually provide for limitations on partial withdrawals and loans to prevent the participant's retirement security from being jeopardized.

A number of profit sharing plans also invest in stock of the employer. In this way the employee not only shares in the profits of his employer, but is also given a proprietary interest in the success of his employer. In this way the employees are made true partners in the employer's business. This stock is often distributed to employees at retirement and permits them flexibility in meeting their retirement needs.

One of the chief objectives of most profit sharing plans is to provide an accumulation of retirement capital for the employee and not necessarily a form of fixed annuity income. This capital makes it possible for retired employees to maintain the flexibility needed to meet changing conditions during their retirement years. For example, in addition to providing retirement living expenses, a profit sharing lump sum payment allows the retired employee to pay off the mortgage on a home, to move to a more favorable climate and purchase a retirement home, to have the funds for costly medical care and to make investments to maintain the level of his economic security in retirement.

We have witnessed the debilitating effects of inflation. We have seen that a more-than-adequate pension, as judged by standards 25 years ago, will not even meet today's test for determining the poverty level. We believe it is most unfair to force an employee to receive his profit sharing accumulations in an annuity or a similar fixed type of periodic retirement payment and thereby subject these funds to the eroding effect of inflation and depreciation in the purchasing power of the dollar. A lump sum payment gives the employee the flexibility to protect himself or herself against this risk.

Those who object to allowing participants to receive a lump sum seem to have no confidence in the ability of the American worker to handle his or her own funds in retirement. In the Council's many years of experience the great majority of participants in profit sharing plans want and take lump sum distributions and we have never heard of one instance in which a lump sum given at retirement has been squandered by the participant. If such events were to occur, I am sure that Council members would see to it that profit sharing payments were made on an installment basis since they, too, are concerned with the needs of their retiring employees.

Profit sharing is a superior mechanism for delivering enriching financial benefits to participants in every level of the American economic structure. This is possible because of the following facts, which are characteristic of virtually all profit sharing plans:

- Increased profits produce increased retirement income potential, thus enabling each individual to enhance his or her future security.
- Immediate or speedy vesting common in profit sharing creates early non-forfeitable benefits which become the building blocks of economic independence.
- Fast vesting and lump sum distributions permit employees who don't retire to continue retirement-security building programs by rolling account balances into Individual Retirement Accounts or retirement programs of new employers.
- Departing members' forfeitures are spread among remaining participants; very rarely are they used to reduce employer contributions.
- Participants -- never the plan sponsor -- receive the fruits of successful investment of plan assets. Because the participant is "at risk" many plans offer investment options that permit each person to select the fund which offers the elements which most appeal to him or her at each decision-making time.
- Profit sharing plans that are "integrated" with Social Security are extremely rare. This means that profit sharing benefits to lower-paid participants are not reduced by an amount related to the expected Social Security benefit.
- Terminated plan assets go fully vested to participants. None revert to the employer. Nor is there any involvement of the Pension Benefit Guaranty Corporation.

- Regardless of age or service, accounts of profit sharing participants who die vest fully and are delivered promptly to beneficiaries, usually in the form desired. Disability also brings unqualified full vesting.
- Most plans now permit participants to further enhance their future security by contributing their own money to their account through payroll deduction. Two additional advantages result: "free" professional management of these savings, and tax deferral on the earnings generated.
- Variety of distribution options at retirement (lump sum, installment, annuity) plus rollover capability to IRA, give maximum flexibility for each individual to utilize the method best suited to his or her own needs.
- Favorable taxation at distribution (or further tax deferral on rollovers) means that maximum net proceeds are available for meeting each person's retirement financial requirements.
- Because the retiree upon distribution owns and controls the assets, he or she has unlimited opportunity to take steps to offset the inroads of inflation, pay off the mortgage, move to a retirement residence, or otherwise exercise judgment in matters relating to one's own well being.

We believe that the advantages cited will continue to provide superior economic security to American workers covered by profit sharing plans.

Some objections have been raised to the ability of plan participants to withdraw voluntary savings in profit sharing plans. However, if these withdrawals are prohibited or severely restricted, participants -- particularly younger participants -- will tend not to save, thus diminishing the pool of savings which can be used for retirement in future years. The fact that some of these withdrawals may be used for non-retirement purposes is no reason for eliminating the withdrawals and thereby discouraging younger employees from saving through their profit sharing plan.

The Retirement Income Policy Act creates additional restrictions that would affect both current profit sharing plans and discourage companies considering adopting a new profit sharing plan.

Our last annual survey revealed that the majority of plans with less than 100 participants base their profit sharing contribution formula on a discretionary basis. These discretionary formulas are prevalent in small businesses because the profits of these businesses are cyclical. There may be years in which there are no profits or the profits are needed for the capital needs of the company to assure survival. Our 1984 survey showed that 8.7% of our members made no contribution to their profit sharing plan, and in 1983, 8.4% made no contribution.

About 55% of our members' plans allow for voluntary employee savings to build up retirement income. Again, this is a feature common in small companies.

S.1784 requires that if these voluntary savings are in a retirement plan they cannot be withdrawn before age 59½. This would severely restrict savings in such plans, particularly by younger employees. We feel it is extremely important that young people save in their profit sharing plans because the compounding effect of these extra savings over 20/30 years would result in a more secure retirement. 25% of our member companies have a withdrawal provision and 39% have a loan provision. In our opinion, the encouragement of thrift is much more important than the correction of any minor abuses which may occur in this area.

Under the bill there is an alternative. The employer may set up a non-retirement savings plan to which the employees can make voluntary contributions and make withdrawals. However, in order to have such a plan, the employer must contribute at least 3% of compensation every year to the retirement plan, regardless of what the company's profitability or capital needs may be. If the employer wishes to maintain the ability to contribute on the basis of profits, employers will be faced with one of two options: either drop the voluntary savings feature, or keep it in place under the payout restrictions of the bill. If the first option is selected, it will reduce the amount of retirement income available to participants. If the latter choice is made, it will discourage employees from making such contributions, particularly younger employees.

Also, the reduction in the Section 415 limits on contributions and the reduction of the annual addition amounts will obviously deliver less retirement income in the future and does not meet the goal of delivering greater benefits to the employees.

The abolition of 10-year averaging and capital gain taxation for lump sum distributions will adversely affect low or middle income employees who often take lump sum payments which are principally used to pay off the mortgage on a home, to move to a more favorable climate and purchase a retirement home, or to have funds for costly medical care. These retirees invest the remainder in safe and secure investments which they can adjust periodically to keep pace with inflation.

Participants who receive employer stock at retirement are particularly harmed by the elimination of 10-year averaging, capital gain and the unrealized appreciation exclusion. Many plan participants who now receive employer stock anticipate keeping the stock at retirement, living on the dividends and selling the stock at a time they choose. If they are forced to rollover their stock into an Individual Retirement Account, not only do they lose this retirement flexibility, they will face additional charges on the rollover and the loss of the unrealized appreciation benefit. The institution that receives the rollover will not do so as a public service. It will be a bank or stock broker or other profit-making enterprise which will charge trustee fees, investment management fees, or brokerage fees.

The bill also eliminates the current provision in the law which allows an employer to have 3-year eligibility if the participant is then vested 100%. This provision has been used by a number of profit sharing plans which have heavy turnover in the first few years of participation, and should be retained.

We believe that the unique benefits to be derived from profit sharing should not be sacrificed to patronizing zeal in protecting the employee by prescribing still another uniform annuity system and restricting the ability of the American worker to handle his or her own money in a way he or she determines suitable.

STATEMENT OF DAVID SILVER, PRESIDENT, INVESTMENT COMPANY INSTITUTE, ACCOMPANIED BY ALFRED JOHNSON, VICE PRESIDENT AND CHIEF ECONOMIST, AND EDWIN S. COHEN, OF COUNSEL, COVINGTON & BURLING, WASHINGTON, DC

Mr. **SILVER**. Thank you, Mr. Chairman.

We usually wear different hats on our encounters.

Senator **HEINZ**. Yes. I am surprised not to see you before the Banking Committee.

Mr. **SILVER**. I am David Silver, president of the Investment Company Institute, the national association of the Mutual Fund industry.

With me today are Alfred Johnson, vice president and chief economist of the Institute, and Edwin S. Cohen of Covington and Burling, our outside tax counsel of many years.

As you know, the Mutual Fund industry has extensive experience in managing the assets of retirement plans. We are pleased to appear before you today to endorse your efforts to develop a consistent national retirement policy.

The institute's members recognize the contributions this legislation will make to retirement security. S. 1784 responsibly addresses a number of critical issues: the need to strengthen private employer-sponsored plans through expanded plan coverage; the requirement that an employer offer a meaningful retirement plan before offering a savings plan; the distinction between retirement and non-retirement savings plans; vesting schedules; and the reliance on the individual retirement account as the primary vehicle for the portability of retirement benefits.

Although we believe that as a whole the bill is properly focused, it would, contrary to its purposes, unduly restrict a key component of retirement security—personal retirement savings in an individual retirement account. I will, therefore, focus my comments on the IRA, which—I might note—makes me the odd man out on all the panels this morning.

Data developed by the institute document the phenomenal growth in IRA's. At the end of 1981 the total pool of IRA assets consisted of $26 billion, and 4 million IRA-owning households. By December 1984, the pool had grown to $132 billion and 23 million households. By year end 1985, the total IRA pool amounted to almost $200 billion. Of the more than 23 million households now owning IRA's, the majority have moderate incomes. Nearly 15 million IRA owners have annual incomes under $40,000. Half of these, 7.5 million, are in the $15,000 to $30,000 income range. A recent survey conducted by Market Facts, Inc., found that among potential new IRA owners, the average annual income is $25,000.

Our research also indicates that IRA's do contribute to new savings and that this contribution will increase over time. We estimate that in 1983 IRA's added at least $10 billion to saving—money that otherwise would have been spent. In addition, another $4.2 billion in accumulated earnings on the pool of IRA assets was automatically reinvested and represents new savings. In total, therefore, IRA's contributed over $14 billion to new savings in 1983, over $18 billion in 1984, and may add to savings as much as $37 billion in 1989 merely from earnings on the pool.

With this picture in mind, there are a few provisions of S. 1784 which concern us, the most important of which would cap section 401(k) plan elective contributions at approximately $10,000. However, in so doing, it also provides for a first-dollar offset against IRA contributions, a linkage we find unwarranted. Thus, once a person contributes $2,000 to a 401(k) plan, he or she would not be permitted to contribute to an IRA. Linking the IRA savings program with 401(k) plans is neither logical nor justified. Each plan serves a different purpose.

The institute opposes any type of offset provision as an oblique attack against the self reliance which is the essence of the IRA. Accordingly, we respectfully urge that the IRA should remain the independent, individually directed program which in a short period of time has proved to be a resounding success.

Thank you, Mr. Chairman.

Senator HEINZ. Dave, thank you very much.

[The prepared written statement of Mr. Silver follows:]

S. 1784, "RETIREMENT INCOME POLICY ACT OF 1985" (RIPA)
STATEMENT OF DAVID SILVER,
PRESIDENT
INVESTMENT COMPANY INSTITUTE
BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS
AND INVESTMENT POLICY,
U.S. SENATE COMMITTEE ON FINANCE
JANUARY 28, 1986

I am David Silver, President of the Investment Company Institute, the national association of the American mutual fund industry. With me today are Alfred Johnson, Vice-President and Chief Economist of the Institute and Edwin S. Cohen of Covington and Burling, tax counsel to the Institute.

The Institute's membership includes 1,455 open-end investment companies ("mutual funds"), their investment advisers and underwriters. Its mutual fund members have assets of about $440 billion, accounting for approximately 90% of total industry assets, and have over 20 million shareholders.

Mutual funds have traditionally served as vehicles through which investors of modest means may channel their investment dollars into the nation's economy through a diversified, professionally managed pool of investments. Mutual funds are increasingly providing the investment medium for retirement income programs.

CONSISTENT NATIONAL RETIREMENT POLICY IS NECESSARY

As you know, this industry has extensive experience in managing the assets of retirement plans. As such, we are pleased to appear before the Subcommittee today, first, to offer our support to Chairman Heinz, his colleagues on the bill, and respective staffs for their efforts in developing a consistent national retirement policy for American workers and, second, to comment on S. 1784, the "Retirement Income Policy Act of 1985" (RIPA).

Since passing ERISA in 1974, Congress has not adequately recognized the growing need for a comprehensive approach to pension legislation. By not doing so, it has created a void which has been readily filled by revenue raising legislative measures that have not taken into account the necessity for a comprehensive national retirement policy. An inevitable tension now exists between those recognizing the need for a policy which creates incentives for retirement savings and those concerned with revenue losses. S. 1784 is an attempt to eliminate this tension, to guide tax and pension law changes toward the goal of enhancing retirement security, and to insure that decisions about retirement benefits not be made with respect to revenue concerns only.

The Institute's members recognize the contributions this legislation will make to the retirement security of millions of Americans. S. 1784 necessarily addresses many critical issues: the need to strengthen private employer-sponsored plans through expanded plan coverage; the requirement that an employer offer a meaningful retirement plan before a savings plan can be offered; the distinction between retirement savings plans and non-retirement savings plans; more rapid vesting schedules; and the reliance on the Individual Retirement Account (IRA) as the primary vehicle for the portability of retirement benefits.

As comprehensive as this bill is, however, we believe that S. 1784 discourages a key component of retirement security: personal retirement savings in an IRA. While the authors recognize implicitly that a sound retirement plan is based on a three-tiered system consisting of Social Security, an employer-sponsored plan, and individual savings, some sections of the bill restrict the universality of the IRA, and consequently the ability of Americans to increase their individual retirement savings.

S. 1784 carefully develops a policy intended to encourage the coverage and effectiveness of the second component of the retirement system, employer-provided pension plans. Yet in the context of clarifying the distinction between employer-provided retirement plans and employer-sponsored savings plans, the bill has, for no apparent reason, limited the third essential component of our national retirement policy -- IRAs -- clearly one of the most significant components of individual retirement savings. Just as the bill would increase employer-provided retirement benefits, IRAs and individual savings must also be increased and enhanced. Personal retirement savings cannot be ignored or decreased as we develop a national retirement policy that assures retirement security to all working Americans. The restriction on the IRA is inconsistent with the bill's otherwise thoughtful efforts to develop a national retirement policy based on the above mentioned three-tiered system.

I would therefore like to focus my comments on the IRA, a retirement vehicle which has proved particularly successful in assisting people to supplement their Social Security and employer-sponsored retirement plan benefits. I will do so, first, by demonstrating the widespread and fundamental use of the IRA as a retirement savings vehicle; and second, by making specific suggestions for change in the provisions of S. 1784 that deal with IRAs, SEPs and the distribution of retirement income.

THE CASE FOR THE IRA

I. IRAs ARE RETIREMENT SAVINGS PLANS FOR MILLIONS OF PEOPLE

Figures developed by the Institute document the phenomenal growth in IRAs. At the end of 1981, when IRAs were first made available to all working individuals under the Economic Recovery Tax Act (ERTA), the total pool of IRA assets consisted of $26 billion dollars and 4 million IRA-owning households. By December 1984, the pool had grown to $132 billion and 23 million households owned IRAs. The Institute estimates that at year-end, 1985, the total IRA pool amounted to almost $200 billion. Growth of this magnitude demonstrates that IRAs meet a critical retirement savings need and that the careful use of favorable tax treatment to accomplish the goal of retirement security deserves continued support.

It is important to point out that it is not the favorable tax treatment alone that makes the IRA so popular. It is a combination of factors:

- universality
- immediate vesting
- portability
- individual control, rendering it less susceptible to the impact of career changes, plant closings, or corporate profitability

Additionally, an Institute survey conducted in late 1984 found that IRA owners give three "extremely important" reasons for having an IRA, all of nearly equal importance:

- "to save on current taxes"
- "to supplement retirement income"
- "because Social Security will be inadequate"

Concerns about the inadequacy of Social Security and the need to supplement retirement income were voiced by IRA owners in virtually all income and age brackets. As might be expected, those under age 40 -- the "baby boomers", if you will -- placed relatively more importance on the inadequacy of Social Security than older IRA owners.

II. MODERATE INCOME EARNERS USE IRAS TO SEEK GREATER RETIREMENT PROTECTION

The more than 23 million households now owning IRAs reflect a broad spectrum of the American public. According to the Institute survey cited earlier, nearly two-thirds (about 15 million) of all IRA owners have annual incomes under $40,000. The largest number of IRA-owning households (7.5 million) are in the $15,000 to $30,000 income range. Thus, even though the

IRA participation rate may be greater in upper income brackets, the majority of IRA-owning households are not wealthy Americans. In short, most IRA owners are neither in the poverty nor the "fat-cat" categories. They represent the core of hardworking Americans who are struggling to meet daily expenses and still set aside something for retirement. It is to be expected, moreover, that new entrants into the IRA program will be drawn largely from people with moderate means. In fact, a recent survey conducted by Market Facts, Inc. found that among potential new IRA account owners, the average annual income is $25,000.

That IRA ownership is already widespread among households with moderate incomes is an important finding. Indeed, it is these moderate income households which are most dependent on IRAs because they frequently represent employees who do not participate or have very modest participations in employer-sponsored retirement programs. Therefore, in the absence of IRAs (or other personal savings set aside for retirement) or employer-sponsored plans, these households could be largely dependent on Social Security payments upon reaching retirement.

S. 1784 recognizes this problem in its entirety by focusing on retirement plan coverage and benefits delivery. By providing broader employer-sponsored plan coverage, RIPA addresses concerns that appear justified in light of the results of a 1982 study of recent retirees conducted by the Social Security Administration. Figures from the study show that great reliance is currently placed on the receipt of Social Security benefits for the financial survival of the recent retiree. Indeed, for retirees in the lowest one-fifth of the income distribution, more than 70 percent of their total income came from Social Security. In other words, as the total monthly retirement income declines, the relative share contributed by Social Security increases. In such cases, it is clear that income from employer pension plans or accumulated assets is minimal or nonexistent. Many IRA owners, however, have recognized the need to supplement retirement income with earnings from accumulated assets. By so doing, they reduce their dependency on the federal retirement system.

III. IRAs OFFER SIMPLICITY, FREEDOM OF INVESTMENT CHOICE

The Institute believes that the IRA, as expanded in 1981 to provide universal coverage to all wage earners of every income bracket, is a unique, simple and effective retirement savings vehicle. The IRA is easily understood and established with a minimum of paperwork and red tape. It is a flexible program enabling IRA participants to exercise their freedom of investment choice through a variety of financial institutions that offer a broad selection of investment products. According to our estimates, IRA owners place their savings in a widely diversified group of financial institutions:

INSTITUTION	PERCENTAGE OF MARKET SHARE*
Commercial Banks	26.4
Mutual Savings Banks	6.1
Savings and Loan Associations	23.0
Life Insurance Companies	8.6
Credit Unions	7.1
Mutual Funds	15.3
Direct Investment in Stocks and Bonds	13.5

As such, not only does the IRA owner's freedom of investment choice allow the individual to determine where and how his or her money will be invested, the resulting diversification also benefits segments of the financial community which might not otherwise gain the infusion of money contributed by people who are saving for retirement.

It is the freedom of investment choice which sets the IRA apart from other retirement savings programs and which is in contrast to the employer-sponsored plan or the Social Security system. Such individual control and freedom of investment choice is a critical component of retirement security, particularly when the other two components -- Social Security and employer-sponsored plans -- are beyond the control of the average employee.

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* Year-end, 1985

IV. NEW SAVINGS GENERATED BY IRAs

Our research also indicates that IRAs do contribute to new saving. This conclusion is based in part on a careful analysis of how IRA owners finance their contributions, recognizing that "new savings" can be an elusive concept. In our survey, for example, we asked people who added to their IRAs in 1983 to specify how the dollar amount contributed was financed -- from current income, prior saving, etc. In addition, we determined whether they would have spent or saved the money in the absence of IRAs. On the basis of direct responses to our questions, we estimated that in 1983, IRAs added at least $10 billion to saving that otherwise would have been spent. This estimate is not only intuitively reasonable, but is similar to results obtained in a 1982 survey conducted by the Life Insurance Marketing and Research Association (LIMRA).

In addition to the new saving out of current income, the accumulated earnings on the existing stock of IRA assets ($52 billion at the end of 1982) produced an additional $4.2 billion (in 1983) -- this represents earnings which were automatically reinvested, not spent. In total, therefore, IRAs contributed over $14 billion to new saving in 1983. By the same process, we estimate that IRAs contributed over $18 billion in new saving in 1984.

This is only the beginning. As shown in the table below, the Institute has conservatively estimated that new additions to retirement savings from earnings on the IRA asset pool may be as much as $37.0 billion in 1989. These figures are based upon a projection that total IRA assets could reach $550 billion or more by the end of the decade. As IRA assets expand over the long-run, they will tend to become a larger percentage of the total financial asset holdings of individuals. This may prompt some individuals to reduce their savings in other forms. But even if the savings estimates shown in the table are discounted by some amount, it seems likely that IRAs will continue to make a significant contribution to retirement savings.

NEW RETIREMENT SAVINGS GENERATED BY IRAS

(Billions of Dollars)

YEAR	IRA ASSETS	NEW SAVINGS FROM CURRENT INCOME	NEW SAVINGS GENERATED FROM ASSETS*
1981	26	(no data)	---
1982	52	(no data)	2
1983	92	10	4
1984	132	11**	7**
1989 (ESTIMATE)	550*	13+**	37**

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*Assumes earnings on IRA assets at the end of the previous year will grow by an average of 8.0 percent.

**The figures for 1984 and 1989 assume patterns of savings behavior similar to that in 1983.

Our conclusion -- that IRAs make a positive contribution to saving -- stands in contrast to the scepticism voiced by critics of the IRA. Such criticism may be based on older aggregate studies and traditional theory, and may lean heavily on the belief that all or most IRA savings are simply a replacement for other forms of saving. This belief greatly underestimates both the attractiveness of the incentives to save in an IRA and the deep-seated need of many people to attain a measure of financial security for retirement. What passes for conventional wisdom is not accurate: the total pool of saving is not finite. Rather, it can be expanded when the incentives and the need are strong enough.

That there is no evidence of a statistical increase in the total U.S. saving rate, looked at from a historical perspective, does not negate the positive impact that IRAs are having. The positive contribution of the three-year-old IRA program to saving, while growing substantially in dollars, is still moderate in terms of the overall universe and has been offset by other negative forces.

Unfortunately, neither the positive nor the negative forces that may influence saving are discernible from Government statistics, since personal saving is measured as a residual -- what's left over after personal outlays are subtracted from after-tax income. Both of these huge variables (themselves subject to substantial error) are currently in the $2.6 to $2.7 trillion range. With income-spending totals of this size being measured against each other to determine the saving rate, it is clear that negative influences on saving -- arising from a variety of forces -- could easily offset tens of billions of dollars of saving thus far generated by IRAs.

If the contributions of IRAs cannot be detected in national savings statistics, it may be that the aggregates themselves are suspect or that other negative forces are offsetting their positive influence. It does not automatically mean that IRAs are not contributing to savings.

These points are underscored in the attached paper prepared by Professor Michael J. Boskin, Professor of Economics, Stanford University, entitled "A Closer Look At Recent U.S. Savings."

Professor Boskin says that:

> "...for those trying to evaluate the impact of tax incentives on saving, e.g., universal individual retirement accounts, the question is not why is the officially measured saving rate still so low? The appropriate question is: What would the saving rate have been in the absence of IRAs?"

Professor Boskin goes on to say:

> "...While no exact answer can be given to this question, I believe that there is substantial reason to believe that the saving rate would be still lower, and the deleterious consequences of under saving still greater had the universal IRA accounts not been instituted."

In the attached paper, prepared for the Institute, Professor Boskin proceeds to outline some of the problems associated with the measurement of the national savings rate -- problems that make it difficult to isolate the savings contributions of IRAs. To cite only one example: Individual Retirement Accounts which are invested in common stocks or equity mutual funds (and had substantial accrued capital gains) would not have these returns included in the standard measure of saving.

Professor Boskin also points out that aggregate saving statistics reflect the activities of different sub-groups, some of which may be saving while others are dissaving. According to Professor Boskin, "part of the likely beneficial impact of the recent increase in real interest rates on private saving has been offset by the greater dissaving of the elderly." In addition, the recent period of high real interest rates has enabled sponsors of some pension plans to meet their actuarially-defined benefit-targets with lower contributions. Professor Boskin cites a study in his paper which indicates that, because interest rates were high, contributions declined by $30 billion in 1984. In that year, the drain on savings from this source, alone, more than offset our estimate of $18.0 billion of new saving generated by IRAs. To repeat, the key question is: What would the saving rate have been in the absence of IRAs?

V. FACING THE "COST" OF THE IRA

Because IRA contributions are tax-deductible, they reduce federal revenues. Unfortunately, it has been the revenue aspect of the IRA that has dominated all analysis of its effectiveness or merit. It has been a debate based in revenue implications only. It is our belief that such a myopic view overlooks the valid, important long-term contributions the IRA makes to retirement security, new savings and long-term capital formation.

According to Treasury estimates, federal revenue loss from the IRA program was about $10 billion in fiscal 1983 and about $11 billion in fiscal 1984. (This revenue loss can be expected to decline with the impact of lower tax rates.) These figures represent short-term drains on revenues, part of which will be recouped when IRA owners draw down their balances at retirement. Another part of the Treasury's short-term revenue loss may be offset over the long-run as new saving created by IRAs provides added stimulus to the economy at large. In 1984, for example, IRAs' contribution to new saving exceeded the Treasury's revenue loss by an estimated $7.0 billion. The allocation of this new saving to capital investment will, over time, increase production and jobs. The Federal Government, in turn, will receive more revenue as profits and income rise to higher levels. The additional savings will also help keep inflation and interest rates at tolerable levels and provide long-term financing to the U.S. Government, home buyers, farmers, and large and small businesses.

Most importantly, as IRA savings grow, they will supplement the Social Security system, the cost of which will continue to escalate as record numbers of Americans reach retirement age early next century. At no time in the history of our country will the need for personal retirement savings be more important. Yet, unless national retirement policy goals are redefined to accomplish this, tax incentives for personal retirement savings will become another victim of revenue raising efforts.

When the sum of all benefits are weighed against costs, it is our belief that the IRA program is a worthwhile investment for all concerned. It will be most unfortunate if this popular and successful program is summarily derailed in the quest for tax revenues.

SUGGESTIONS FOR CHANGES IN S. 1784

I. IRA PROVISIONS

A. "UNLINK" THE IRA AND THE 401(k)

The bill would cap section 401(k) plan elective contributions at approximately $10,000. However, in doing so, S. 1784 also provides for a first dollar offset against IRA contributions, a linkage we find unwarranted. Thus, once a person contributes $2,000 to a 401(k) plan, he or she would not be permitted to contribute to an IRA. Moreover, if a person contributes $2,000 to an IRA, he or she would not be able to participate in a 401(k) plan.

According to recent estimates by both the Institute and the Employee Benefit Research Institute (EBRI), nearly 19 million people are currently eligible to participate in a 401(k) plan. In effect, these wage-earners could be forced to choose between contributing to an IRA (in which they may already have considerable assets) or participating in their company's 401(k) plan. In either situation, a person's retirement security plans can be severely disrupted.

It is our view that linking the IRA savings program with 401(k) savings plans is neither logical nor justified. Each plan serves a different purpose. A 401(k) plan is only available to selected individuals, while the IRA is universally available. The 401(k) plan is a critical component of the second part of the three-tiered system of a national retirement policy, the employer-sponsored plan. The IRA, on the other hand, is personal retirement savings and was established and expanded by Congress in order to supplement employer-sponsored plans. The 401(k) plan investment objectives are controlled by the employer; the IRA investment objectives are controlled by the individual.

The proposed linkage between IRAs and 401(k)s seems to occur most in the context of dealing with revenue implications of 401(k) plans. However, linkage of the two plans is not a rational response to this or any other perceived 401(k) problem. Specific problems with 401(k) plans can and should be dealt with by specific cures.

The Institute opposes any type of offset provision as an oblique attack against the IRA. Not only would such offsets have the ultimate effect of reducing IRA contributions, they would defeat the separate and distinct retirement savings purpose served by IRAs and section 401(k) plans.

Accordingly, we respectfully urge that the IRA contribution limits should remain independent of contributions made by employees to any employer-sponsored retirement plans, whether or not the employer plans are 401(k) plans.

B. INCREASE THE SPOUSAL IRA

If you wish to rely more heavily on the IRA as the primary vehicle for supplementing Social Security and employer-provided retirement plans, and we think you should, then we would encourage the Committee to adopt a proposal to increase the annual spousal IRA contribution limit from $2,250 to $4,000. Unfortunately, this proposal (contained in the President's tax reform proposal) has been dropped by the House of Representatives in its tax reform package. We believe that an increase in the spousal IRA, however, is an integral part of retirement security for a component of the workforce that is often overlooked and often in most need of income when they are older. It would eliminate the existing inexcusable discrimination against spouses who work in the home and would afford equal treatment to those families with one wage-earner by permitting them to contribute as much as $2,000 each year to a spousal IRA.

C. PENALTIES

If in considering the increase in the spousal IRA and attendant changes in the IRA, the Subcommittee believes it also necessary to increase the penalty for early withdrawals to ensure that IRA savings remain retirement savings, we would not object. Our survey shows that along with the concern about the adequacy of Social Security income and the desire for current tax savings, retirement planning is a primary incentive for establishing an IRA. An increase in the penalty rate is of little concern to current IRA owners, although penalties seem to discourage younger participants because of their need to access their savings. While no figures are available on the withdrawal patterns of IRA holders, the mutual fund industry has reported that there is no evidence of abuse in the IRA system. Whether or not this is the result of the substantial 10% penalty currently applicable for early withdrawals, the fact remains that IRA contributions are generally left to grow and accumulate as retirement savings. For these reasons, it remains our belief that the IRA is nearly exclusively used for retirement savings.

II. SIMPLIFIED EMPLOYEE PENSION PLANS (SEPs)

In 1978, provisions for a Simplified Employee Pension (SEP) program were enacted to permit small employers to establish, in an inexpensive manner, non-discriminatory retirement plans for their employees by setting up IRAs for each employee. However, it has been the experience of the mutual fund industry that the SEP program has not been used extensively. Unfortunately, the term "simplified" has turned out to be a misnomer. We believe that further "simplification" would have the highly desirable effect of encouraging small employers to provide employer-sponsored retirement programs for their employees on a non-discriminatory basis.

As such, we are pleased to note that S. 1784 recognizes the utility of SEPs in expanding private employer-provided pension coverage to a greater number of working Americans. Particularly in the case of smaller employers, we believe that the SEP can and should be an attractive, easy-to-administer retirement program.

We are concerned, however, that the provisions of the legislation relating to SEPs may not encourage the growth and development of the private pension system that you seek. In some ways, the bill could discourage expanded SEP coverage. For example, limiting the availability of the salary-reduction SEP to companies with fewer than 25 employees seems an unnecessary restriction on a significant opportunity to expand pension coverage to employees currently not receiving pension benefits. Why should employers with 30, 35, or 100 employees be denied the opportunity to establish such a SEP?

Similarly, we question the decision to prohibit the use of integration in a SEP. If the provisions of the bill relative to Social Security integration rectify the current inequities found in integrated qualified retirement plans, why should integration be entirely prohibited in SEPs? This distinction also appears to be an unnecessary discrimination against SEPs and smaller employers. To the extent that integration with Social Security represents a limited but legitimate cost-savings made available to employers maintaining qualified plans, this feature should also be made available to employers maintaining SEPs.

Instead of limiting the use of SEPs among small employers who may not currently be providing retirement benefits to employees, the Institute recommends that the Subcommittee consider the adoption of other measures designed to encourage the creation and use of SEPs by simplifying further the SEP program. The Institute has received favorable comment on a number of its suggestions both on the Hill and from the Treasury Department. Our proposal would make changes while maintaining the basic structure of the SEP as it exists under current law. Among these suggestions are the following:

* The present SEP system treats the employer contributions as compensation to the employee and allows an offsetting deduction to the employee on his income tax return. The employer contribution is not subject to income tax withholding or FICA or FUTA tax. Nevertheless, it must be reported as taxable compensation on the annual Form W-2 provided to the employee. The adverse consequences of these requirements is that an employee, ordinarily eligible to use simplified income tax forms (1040EZ or 1040A), must now use the long Form 1040. None of these complications exists if employers maintain other types of non-discriminatory retirement plans for employees. Current law should therefore be amended so that amounts contributed on an employee's behalf would be excluded from the employee's income under Code section 402, as are contributions to qualified plans.

* As under qualified retirement plans, SEP contributions would be treated as a deductible employer contribution which could be contributed to the SEP on the basis of the employer's fiscal year. Unlike current law which requires that SEP contributions relate to the calendar year, even in the case of a non-calendar year employer, the Institute proposal would permit contributions to be made to the SEP on or before the date by which the employer must file his tax return, plus any extensions thereto.

We urge that these and other unnecessary complexities be eliminated in SEP plans in order to facilitate the use of these plans by smaller employers.

III. DISTRIBUTION OF RETIREMENT INCOME SHOULD NOT BE LIMITED TO COMMERCIAL ANNUITIES

Although we do not believe that the intent of S. 1784 is to limit benefits payable before age 59 1/2 to those payable under a commercial annuity contract, clarification of this point is necessary because there is a potential ambiguity in the language relating to the retirement income distribution requirements of the bill. Specifically, the bill would mandate that benefits distributed before age 59 1/2 be paid out in a "retirement income form." Permissible "retirement income forms" include level benefit payments over life expectancy, including, presumably, both installment payments from a plan and payments under a commercial annuity contract. But this is not clear.

Unless the language of the bill is clarified, commercial annuities will gain an unfair competitive advantage over those financial products equally capable of providing a constant retirement income stream. For example, a mutual fund or a depository institution could provide benefits through "substantially equal" installment payments extending over the life expectancy of a participant or a participant and a spouse. In fact, there is no reason that an annuity should be viewed as an inherently superior product. Mutual funds have a long history of quality investment performance.*

Moreover, if certain defined contribution plans invested in mutual funds are required to offer benefits in the form of an insurance company annuity contract, significant amounts will have to be withdrawn from mutual funds for the purchase of annuity contracts. In addition, plan participants would be denied the opportunity to fund their retirement plan through their preferred investment medium. Unless clarified, the bill could limit investment choice in an anticompetitive manner by requiring plans to provide for the purchase of a commercial annuity contract.

We have become increasingly concerned with the imposition of a commercial annuity payout provision. If the intent of this bill is to ensure that retirees receive benefits in a steady retirement stream, then we believe that such a purpose can be accomplished through the use of a variety of financial vehicles without favoring insurance companies over other providers.

The Institute is appreciative of the opportunity to appear before you and looks forward to additional discussion of all of these matters.

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* Available data from 1979 to the present, the average annual return on money market funds has ranged between a low of 7.1 percent and a high of 16.8 percent. (From Donoghue's Money Fund Report.) For the past ten years common stock mutual funds have performed at an average annual rate of about 15.0 percent, and for the past twenty-five years common stock funds have performed at an average annual rate of about 9.3 percent.

Senator HEINZ. Gentlemen, you have provided a lot of very interesting insights into our legislation. Some of you have said don't do anything in the tax reform bill. Mr. Hurd said you have got some good ideas here; let's work them out; let's refine them. That sentiment has been supported in varying degrees by each of you. You have all agreed with the goals, just the implementations are a small problem here and there, as with most legislation.

What is a small public policy problem to us, of course, may be a major problem to any individual group or individual company.

Mr. Hurd proposed some methods of raising the revenue to pay for the cost of tax return. The House and the administration between them try to raise in the pension, IRA, 401(k) area, between $13 and $18 billion over 5 years. And a good deal of that money is raised from the repeal of 3-year basis recovery.

Mr. Hurd advocates that as a way of making a down payment on tax reform. We used to make down payments on the deficit, now we make it on tax reform. What kind of problems does the repeal of 3-year basis recovery cause if we do it separately from tax reform? Anybody except Mr. Hurd, the advocate.

Mr. Holan.

Mr. HOLAN. There is a problem in profit sharing because we have had voluntary savings for years and years, and the employees have been told that where withdrawals are made, the voluntary savings come out first rather than as is done in the reordering.

It is going to create tremendous complexity in some of these plans in keeping records, and I know the employees are not going to appreciate it.

Senator HEINZ. Now what about you, Mr. Handy?

Mr. HANDY. Very minor problems.

Senator HEINZ. John Erlenborn?

Mr. ERLENBORN. Since I have already begun recovering my contributions and I would be under the grandfather clause in any event, personally it makes no difference.

If I understand the provision correctly, it affects only those amounts that go into the accounts or that are attributed to the accounts after the effective date rather than those already in the account.

Senator HEINZ. I am not sure on that.

Mr. ERLENBORN. If it isn't that way, it ought to be that way. [Laughter.]

So you are not changing the rules after the contributions have been made.

Mr. HOLAN. The voluntary contributions made prior to January 1 do come out first tax free without any effect on the recovery rule.

Mr. ERLENBORN. That was my understanding.

Senator HEINZ. We are both right. [Laughter.]

I will not try and repeat what a very able staff associate whispered to me, but the answer is yes and no. [Laughter.]

John, you really counseled the same thing as Dave Hurd, which is don't act; sink H.R. 3838, at least the pension provisions of it. Maybe you would like to go further than that, and don't modify current law for pensions and retirement income as far as tax reform.

Let me ask you the open-ended question. Would you pay for the revenue loss of not modifying retirement savings law more or less the same way that Dave Hurd would? If we don't pay for it his way, we have to pay for it some other way if we are going to have revenue-neutral tax reform.

Mr. ERLENBORN. I am not certain that I recall exactly what his proposal was.

Mr. HURD. Could I touch it just for a moment?

Senator HEINZ. Yes.

Mr. HURD. In effect, I was saying if something has to be done there, let us do it in such a way that it minimizes disruption of employer-sponsored plans, and, therefore, go only as far as you have to into offsetting IRAs for people who are currently having vested contributions made for them to employer-sponsored plans.

Senator HEINZ. Let me ask you: Of the three revenue-raising postponement devices you mentioned, I can put a price tag on the repeal of 3-year based recovery rules of about $7 to $11 billion, depending on whose estimate is made when. What about eliminating the so-called double dipping for IRA contributions and the proposals in point number two?

Mr. HURD. Well, I don't know that there is a precise figure. But if you went all the way with that, it might be in the general vicinity of half the IRA tax expenditure so you would be up in the area of $30 billion over a 5-year period. So, clearly, you would not have to go all that distance. You could go there part way by sort of a percentage offset. You could say, well, we will offset 20 percent or 40 percent or some number like that of vested contributions made to the employer plan against IRA availability.

Mr. SILVER. Mr. Chairman, at an appropriate time, I would like to note my exception to lightening the lifeboat the way Mr. Hurd suggests.

Senator HEINZ. This is as good a time to comment as any. Go ahead.

Mr. SILVER. Well, I think that in the IRA we see really for the first time the fulfillment of the three-tiered system that we have talked about so much. And, that is, encouraging the individual to plan for his or her own retirement in a meaningful way.

After 4 short years, IRA assets have totaled $200 billion. If we look at the sum total of all the non-insured employer sponsored plans. I think the total is something like $600 to $700 billion—We have built up a third of that sum through individual initiative in 4 short years.

The IRA works. It is simple. There are no vesting problems. There are no coverage problems. There are no withdrawal problems as far as we can tell. We do not think that this is the time to throw out the baby with the bath with respect to the IRA.

We have other matters which we are deeply concerned. And I share the views of this panel that we would leave pension reform for another day, generally, rather than taking the approach of the House bill. We have seen too much change in the name of reform in the last three tax bills in this area.

But I would say give the IRA a chance to work. It is working well, and it is working in the interest of 32 million households at this point.

Senator **Heinz**. Let me go back and ask Mr. Hurd this question: We have talked about your and I think everybody's general philosophy on how we ought to approach this issue. Going to the specifics of the issue, if you had to point to one provision in our bill that would be most worth doing from a retirement-income policy standpoint, what would it be?

Mr. **Hurd**. I guess I haven't really thought about that, as to what would be the most important step to take, Senator Heinz.

Senator **Heinz**. Let me give you a chance to think about it, and I will start at the other end.

Mr. **Handy**. I would certainly like to hear the middle ground first. [Laughter.]

Senator **Heinz**. From the standpoint of retirement policy. John, do you want to take a crack at that?

I don't feel it is unfair to ask John Erlenborn that question.

Mr. **Erlenborn**. Without a lot of deep thought, let me say that the concept of delaying the effective date. [Laughter.]

Senator **Heinz**. At what date do you retire, John?

Mr. **Erlenborn**. As far as possible.

Senator **Heinz**. Quite seriously, would you like to take a crack at that question?

Mr. **Erlenborn**. Well, I am not certain that I could set priorities. I do like the approach to the 415 limits, however. That, I think, is very important.

We had 415 limits established by ERISA, $25,000 for defined contributions, $75,000 for defined benefit. They were indexed, they grew—I have forgotten the exact figures, but I think the defined benefit was up around a $135,000 or thereabouts. Then in TEFRA, they were reduced to the "90–30" where they are today, they were frozen for a couple of years, and then the freeze was extended. Now the House tax bill that is pending in the Senate would put the limits back almost to where we were in 1974, to $77,000 and $25,000.

I am afraid that this is done purely for revenue considerations alone and without understanding the impact on funding defined benefit plans. I think a lot of Congressmen and Senators look at the $90,000 or $77,000 and think of it in terms of current benefits being received when it is truly a funding limit for benefits that may not be received for 20 or 30 years down the road.

This freezing and reducing of these limits, could affect people who today are getting modest salaries. A 25- or 30-year-old worker making $20,000 or $25,000 would be affected as to the funding for their ultimate benefit. It is not just in terms of current levels of benefits.

I think trying the 415 limits to the Social Security wage base would give a degree of predictability that is very important.

Senator **Heinz**. I appreciate that, and I suspect that sentiment is—is there anybody who disagrees with that notion on 415? Pretty broad acceptance of what we are doing there, I gather.

Mr. **Hurd**. Very broad acceptance of indexing the limits in a continuing way, if, in fact, there must be specified dollar limits. But we feel that this is one of the areas of chipping away at creation of new plans and maintenance of good benefit formulas under existing plans by having a specified dollar limit at all. That it is in the name of holding down benefits for the fat cats, but the impact is to minimize benefits for rank and file.

Senator HEINZ. Let us go through some of the central issues here. Laying aside the effective dates and all of that, just to get a sense of where you all are, on some of the key provisions. Five-year vesting.

Now, Mr. Hurd, my understanding of your position is you are not enthusiastic about 5-year vesting, but in the context of an overall approach, you would be willing to go along with it. Is that right?

Mr. HURD. Yes. We would be far more willing to take that than say the requirement that the profit sharing employer, and that is his only plan, has to put in money in non-profit years.

Senator HEINZ. Mr. Holan, how do you feel about that?

Mr. HOLAN. Mixed feelings. I think most of our members would probably go along with it. But some of them are concerned with the turnover they have in the first few years. And some employee committees, actually, have objected this on the basis that short-term employees don't contribute to profits. We discovered this a couple of years ago.

Senator HEINZ. Mr. Silver.

Mr. SILVER. I think the concensus of our members would be affirmative.

Senator HEINZ. John?

Mr. ERLENBORN. Very negative. First of all, the proposal would leave 10-year vesting for negotiated plans, which would give an advantage. A union could go into a factory that was unorganized and say we can get greater benefits for you by negotiating a plan with 10-year vesting because there is a cost to vesting, and that cost to vesting takes from the value of the benefits that the participants receive.

The other thing is that the only value of early vesting is to the one who separates from service before the longer period. So we are talking about people with relatively small benefits after 5, 6, 7 years. What they will traditionally do, and it is very understandable, is take a lump sum distribution. That is to the benefit of the employer so the employer does not have to carry it on the books. If the employer had to carry it for these young people, and most of them would be, for 20 or 30 years, the cost of these small benefits being carried on the books is disproportionate.

So what you really are doing with this is creating a severance pay plan in the guise of a pension plan, that people with short periods of service get cash when they leave. And I am not certain it is worth the effort and the cost to tamper with pension plans to give severance pay.

Senator HEINZ. If you get that lump sum distribution, our legislation requires it be rolled into an IRA, we tighten up somewhat the distribution penalty; we increase the tax on early distribution so that it actually costs you something to take your money out of an IRA as opposed to making it rather attractive to take it out and spend it. Another way to looking, therefore, at what we are doing is we are giving employees an opportunity to build some savings. Maybe that 42-year-old engineer who never thought in his first job about setting up an IRA. Or there is some life insurance company that runs ads, about a retired 37-year-old football player; who wants to be remembered as a good husband, good father. I don't know whether the fellow did or did not get visited by his insurance agent when he signed.

But there is something to be said for getting people on the savings track at the earliest possible date. We have got a way of doing it here.

You are saying it is not a good idea. How do we do it?

Mr. ERLENBORN. I question whether this is the savings track.

Senator HEINZ. Give me some other alternative.

Mr. ERLENBORN. Well, if someone leaves with 6 years of service and they get a lump sum settlement of $1,200, I doubt that that is going to be used for retirement purposes.

Senator HEINZ. Under the bill, though, they are required to roll it into an IRA.

Mr. ERLENBORN. Well, they can take it right out of the IRA, too.

Senator HEINZ. But they right then pay a 20-percent tax on it, too. And maybe they will take it out and maybe they won't. Your logic is put a 50-percent tax on it for the first 5 years so they get to like it, I guess. Is that what you are—where does your logic lead you?

Mr. ERLENBORN. Well, I am looking at a defined benefit pension plan sort of as insurance. There are elements in that plan that make it possible to give meaningful benefits because not everyone is going to get everything that was paid in on their behalf. And the earlier you make vesting, the more you are making it look like a defined contribution plan.

If you had immediate vesting, I do not think you could have meaningful benefits from a defined benefit plan because the contingency of those who do not vest has been taken out of the plan. So you are taking part of the funding mechanism away by earlier vesting.

Senator HEINZ. I understand that. The benefit we are looking for is a benefit, I suspect, you support, which is getting more people of their own volition predisposed to and practicing savings for the future, especially for retirement. And I worry about the fact that a very relatively small—I should not say very "small." It is not very small. It ends up about 40 percent of the people who will be retiring at some point are expected to have some kind of defined benefit or defined contribution coverage. I worry what happens if we do not change our policy when the other 60 percent of the people say, hey, this is not benefitting me and a Democracy majority rules, there is 60 percent of us, there are 40 percent of them, and to hell with all those defined benefit and contribution plans that John Erlenborn and everybody else was arguing for. Then where are we?

Mr. ERLENBORN. Well, I think maybe a better way of doing it is through something like a 401(k) plan with matching. I think that entices people into saving more than participation in a defined benefit plan.

Senator HEINZ. Any other comments on this?

Mr. HANDY. I would like to make a couple of comments. You have got the savings plan out there. There are so many of them. They are very common. Usually, they provide five-year vesting. In fact, our plan vests after 2 years, 25 percent; 50 percent after 3 and so forth until it is 100 percent vested after 5. So those savings plans are there; they meet the need that you are discussing.

Second, the benefits of 5-year position are minimis. I have done some calculations for people with a $15 unit benefit plan and for $20,000 final average pay under 1.5-percent strip-rate pension plan, and it turns out that the single sum value that a person might have a at age 32 in either case would probably be little more than the aggregate cost of the proposed $8.50 annual premiums to the Pension Benefit Guarantee Corporation that would be payable if the plan held the benefit until the employee was 65.

So they are very, very small benefits. And that does not take into account any kind of administrative costs. Maybe we should focus on encouraging savings and make the contributions to the savings plans vest more rapidly.

Senator HEINZ. All right. Let us go onto another issue; namely, the integration rules which we proposed. And, again, I am going to start with Mr. Hurd because he was our first witness.

Dave, you support the integration rules with some refinements. Is that right?

Mr. HURD. Yes. We think they are a useful simplification of present rules. And the only area of concern that we want to do a little study on is whether for the very low income, very long-service employee what the result it. But we generally support it.

Senator HEINZ. Mr. Holan, do you have a position on that?

Mr. HOLAN. Very few profit-sharing plans have integration.

Senator HEINZ. Yes; I would not think there would be an issue there.

Dave?

Mr. SILVER. Senator, we agree with your approach. We would carry it one step further, though. We note that you do not, for reasons we do not fully understand, permit integration at all with SEP's. With SEP, simplified plans. But we agree with your approach.

Senator HEINZ. John?

Mr. ERLENBORN. The reform in the integration rules is long overdue, and I think the approach in your bill is very good.

Senator HEINZ. Mr. Handy.

Mr. HANDY. I agree.

Senator HEINZ. My goodness, with one nolo contendere, there is unanimity there. We are making progress here.

I am not going to ask about the effective dates. I think everybody on that point is clear.

One of the problems with not paying any attention to the questions your staff prepare for you and asking questions that seem relevant at the time is you may skip over some important questions.

I have one question, one and a half question maybe, for Mr. Handy, which I think probably Senator Chafee would like me to ask, too.

Mr. Handy, as I understand it, Textron currently has a defined benefit plan plus a 401(k), and after-tax savings plan. The pension plan and 401(k), presumably they are to pay retirement benefits. Employees cannot draw on their 401(k) while they work for Textron unless they prove they are in extreme hardship.

Mr. HANDY. That is right. We have had the 401(k) feature in our savings plan, Senator, for 2 years. In that time, we have approved three hardship distributions.

Senator HEINZ. The after-tax portion of the savings plan is intended to give employees greater flexibility, as I understand it. They can use their savings to purchase a home or pay for education expenses or other needs. In your testimony you stated that our bill is pointing toward a uniform master plan for all Americans, like it or not.

This implies that under the Retirement Income Policy Act a company couldn't offer these kinds of options to employees.

Could you describe the changes you would have to make, in Textron's plans if we enacted this?

Mr. HANDY. As I said earlier, if I understood your floor statement, our savings plan would literally be shot out of the water by your bill because it does not have 60-percent participation.

Page 6 of your floor statement seems to make it clear that the 60-percent rule applies not only to retirement plans, but to savings plans that supplement retirement plans. Your floor statement may be inconsistent with the bill or I may have misunderstood it. There does seem to be an inconsistency with the bill.

Senator HEINZ. Let us take a step backward and look at the philosophy behind the bill, which is the idea of making a distinction between retirement and non-retirement savings. Do you generally support the notion that we should make that kind of a distinction?

Mr. HANDY. Well, I think, in fact, it is there. Yes; I think the distinction is a realistic one. But I do think that in order to accomplish the objective of maintaining pre-retirement living standards you cannot do it with a pension plan that accrues at the rate of half of 1 percent a year plus Social Security. You have got to have savings.

Senator HEINZ. Yes.

Mr. HANDY. And so it seems to me you want to continue teaming savings and pension plans. And we need the savings plans, as another source of retirement income. It is a very important source, and it is an area where industry and government can work hand in hand. I think we should. I think it is there. It is an existing system that should be built upon instead of eroded.

Senator HEINZ. Well, the principal difference between a retirement and a non-retirement savings plan, of course, is that a retirement savings plan is going to be used for retirement. You say we need more savings for retirement. And, therefore, the problem is if we have savings that are used for consumption pre-retirement, how does that advance to what we both want to do, which is to increase the pool of savings for retirement?

Mr. HANDY. I would like to call the Senator's attention to the exhibit of the 20 people retiring within the last year that we really picked at random on very short notice. There in most cases the distributions from the savings plan were considerably larger than the value of the portions. Note that the savings plan distributions were two-thirds derived from the employer's own contributions.

Senator HEINZ. Yes.

Mr. HANDY. But people are using savings plans for retirement. There is no question that young people, first, will not put money in, at least in our experience, if they think they cannot get the money out for buying a house or educating children. When they get to the point of paying college bills, they use these most carefully. As they come closer and closer to their retirement years, they are more likely to leave the savings untouched.

Senator **Heinz**. With the previous panel of witnesses, I think we had a good, productive discussion of the importance of perception and the difference with reality and the definitional questions of how we can on the one hand encourage people to save for retirement—give them the kind of flexibility they think they need—and we had some good ideas as to how we might in the practical sense bring that about. Do you have any ideas in that regard?

Mr. **Handy**. One more point. And that is that possibly your withdrawal rights, your hardship withdrawal rights, be limited to after-tax contributions; not company contributions.

I do not think there is any employer that I know of that has any interest in maintaining tax-free checking accounts for employees. I sort of sense that that is the kind of savings plan that the bill is talking about. I do not think we want it. I think we, as employers, are interested in people providing for their very substantial needs aod certainly providing retirement income.

It seems to me a savings account that employees can get immediate access to anytime they want for any purpose they want is essentially a tax dodge.

Senator **Heinz**. I think you have got some interesting thoughts there.

Let me return to answer a question that you posed earlier. Either I misspoke or I think you misinterpreted my Floor statement. In our bill, we have a special rule for contributory plans which in the general case is that where mandatory contributions are involved in a retirement plan, you have to have at least 60 percent.

Mr. **Handy**. Mandatory contributions meaning the employee has to contribute in order to get a contribution from the employer?

Senator **Heinz**. This is in a retirement plan.

Mr. **Handy**. All right.

Senator **Heinz**. Strictly a retirement plan; not a savings plan.

Mr. **Handy**. I think page 6 of your floor statement perhaps is inconsistent.

Senator **Heinz**. We will revise and extend just as quickly as we can.

All right. Thank you very much.

Any other comments?

[No response.]

Senator **Heinz**. If not, I thank you all. I appreciate the great talent and insights you have given us. Thank you all very much.

Our last set of witnesses, if they will please come forward, are: Anne Moss, Mary Gray, Bill Hoffman and William Welsh.

Ladies and gentlemen, we welcome you. I am going to ask Anne Moss of the Pension Rights Center if she would please be our first witness. We will then proceed to Dr. Gray, Dr. Hoffman and then Mr. Welsh in that order.

Ms. Moss, please proceed.

Ms. Moss. All right.

STATEMENT OF ANNE E. MOSS, DEPUTY DIRECTOR, PENSION RIGHTS CENTER, WASHINGTON, DC, ACCOMPANIED BY KAREN FERGUSON, DIRECTOR OF PENSION RIGHTS CENTER

Ms. Moss. I am Anne Moss. I am the Deputy Director of the Pension Rights Center. With me is Karen Ferguson who is Director of the Pension Rights Center.

The Center is a nonprofit public interest group that has been working for the past 10 years to make the Nation's pension systems fair and responsive to the needs of workers and retirees. TEFRA and the Retirement Equity Act have made it possible for thousands of workers and spouses to become eligible for pensions. Now we are looking to Congress to make the far-reaching and fundamental reforms that will finally let the system provide for all working Americans a realistic supplement to Social Security.

To us, the Retirement Income Policy Act is an exciting and extremely important bill. It addresses three of the most pressing problems of the Nation's private pension system: The trend toward capital accumulation plans and away from conventional oension plans; the inequities of private pension plans that unfairly penalize mobile and lower-paid employees; and the lack of pension coverage among small companies.

We support the general proposals of S. 1784, but we think their effect and the bill's ability to achieve to its stated national retirement policy goals are compromised by other provisions in the bill that we oppose.

We do support trying to curb the trend toward capital accumulation plans that displace traditional pension plans. The bill would make these types of plans, especially 401(k)'s, less attractive to employees by locking in contributions until retirement age.

From both a tax policy and a retirement income policy perspective, this makes excellent sense. The tax breaks given to employee contributions to these plans is justified only if the money is actually being saved for retirement.

But we think 401(k)'s will still be attractive to employers as opposed to employees because employers only have to provide a match sufficient to induce the requisite number of lower-paid employees to participate.

We do support voluntary saving for retirement for people who can afford it, but we still believe that for those workers who can't afford to save, traditional employer-sponsored and employer-paid pension plans have the greatest potential for delivering adequate retirement benefits. Yet employers who can rely on do-it-yourself arrangements are less likely to improve their basic pension plans.

So we urge you to reconsider the bill's provisions that still preserve 401(k) plans.

We support requiring an employer who wants to set up a so-called non-retirement plan to also have a retirement plan requiring a certain minimun benefit. But we would urge you to make it larger than the one-half of one percent of compensation per year of service since low-wage workers may have nothing else but this pension in addition to Social Security.

In other areas, the bill does eliminate some of the worst abuses of the private pension system, but it may also create some new inequities. In the coverage area, we do like expanding the coverage requirements, but workers over the Social Security wage base should also be covered. That would give an employer an incentive to improve the plan that also includes rank and file workers.

In the vesting area, we support 5-year vesting, but we would like to extend it also to multi-employer plan workers.

In the integration area, we certainly support eliminating the abuses that would result in workers completely integrated out of their benefits.

We hope that you will look into some of the fundamental reasons for integration, though, and see if they still hold up.

Finally, it is very significant that the bill promotes the coverage of workers in small companies. It does this by prohibiting integrated simplified employee plans or SEP's. We thinks SEP's are a great idea for small companies who have not been able to set up a traditional pension plan. And we look forward to seeing more financial institutions and organizations promote SEP's.

Thank you. We will take questions.

Senator HEINZ. Ms. Moss, thank you very much.

[The prepared written statement of Ms. Moss follows:]

STATEMENT OF THE PENSION RIGHTS CENTER ON S. 1784—THE RETIREMENT INCOME POLICY ACT

Mr. Chairman, Members of the Subcommittee, I am Anne Moss, Deputy Director of the Pension Rights Center. The Center is a nonprofit public interest group that has been working for the past ten years to make the nation's pension system fair and responsive to the needs of workers and retirees.

The Tax Equity and Fiscal Responsibility Act of 1982 and the Retirement Equity Act of 1984 have made it possible for thousands of workers, widows and divorced women to become eligible for pensions. We now look to Congress to make the far-reaching and fundamental reforms that will finally allow the private pension system to provide for all working Americans a realistic supplement to social security.

We are pleased to have the opportunity to testify this morning. The Retirement Income Policy Act is an exciting and extremely important bill. It addresses three of the most pressing problems of the nation's private pension system:

- the trend toward capital accumulation plans and away from conventional pension plans;
- the inequities of private pension plans that unfairly penalize mobile and lower-paid employees; and
- the lack of pension coverage among small companies.

The bill seeks to stop the encroachment of capital accumulation plans on pension plans by making a distinction between retirement plans and non-retirement plans and requiring that an employer maintain a retirement plan as a precondition to establishing a non-retirement plan. We support these proposals.

The bill targets inequities in the coverage, vesting and integration rules governing conventional pension plans. It requires that an employer offer retirement plan coverage to all employees of an employer in a single line of business who earn less than the social security wage base. It requires that employees covered by single employer pension plans vest, that is, earn the right to employer-paid benefits, after five years of work. It does away with practices that may entirely eliminate the pension benefits of lower-paid workers through the "integration" of their pension benefits with their social security benefits. We support these proposals.

The bill also deals with the problem of lack of pension coverage in small companies. It recognizes that SEPs, Simplified Employee Pensions, are a simple, low cost way for small business owners to provide pension benefits for themselves and their employees but that employees are unlikely to urge their employers to set up SEPs unless they can be assured of receiving benefits from these plans. The bill prohibits the integration of SEPs with social security, thus guaranteeing that employees will receive pensions if their employer sets up one of these plans. We support this proposal.

While we support the proposals I have just summarized, their effect and the bill's ability to achieve its stated goal of "delivering adequate retirement benefits to the nation's work force"are compromised by other provisions in the bill that we oppose.

First, the bill provides that employers may use 401(k) plans to supplement or substitute for conventional retirement plans. This would exacerbate the trend toward capital accumulation plans, ostensibly for retirement, and away from conventional pension plans.

Second, while the bill's coverage, vesting and integration proposals would help many people, they would create new inequities that would make it impossible for the private pension system to achieve its potential of providing a realistic supplement to social security for most working Americans.

Third, the bill contains provisions designed to make Simplified Employee Pensions more attractive to employers, by allowing the inclusion of tax deductible employee contributions. These provisions are unnecessary and could forestall the use of SEPS as a meaningful source of employer financed benefits for rank and file workers.

I. The bill proposes to curb the trend toward capital accumulation arrangements that supplant conventional pension plans. However, it may unwittingly exacerbate that trend, thus seriously

undermining the retirement income security of many American workers.

A. 401(k) plans. The bill takes aim at one cause of the trend toward capital accumulation arrangements. It recognizes that these arrangements are popular with employees because they generally permit employees to withdraw money before retirement. The most popular of these arrangements, which also is the newest, is the 401(k) plan. Current law permits employees to reduce their taxable income by the amounts contributed to a 401(k) plan, and then withdraw the amounts when they leave their employer or, typically, to buy a house, put their children through college or for medical emergencies.

The bill seeks to diminish the attractiveness of 401(k) plans by "locking in" contributions to these plans until retirement age. From both a tax policy and a retirement income policy perspective this makes excellent sense. Most of the money going into 401(k) plans is money that would have been saved in other forms. The tax breaks given to employee contributions to these plans is justified only if the money is being saved for retirement.

The bill is likely to reduce the attractiveness of 401(k) plans to employees not interested in locking in money for retirement, but it should also lessen the enormous appeal of these plans to employers.

For employers, 401(k) plans represent a too-good-to-be-true alternative to improvements in their conventional pension plans - and in some instances to the pension plans themselves. Rather than making contributions for all employees as required by most pension plans, 401(k) plans, at most, require contributions only for those employees who can afford to make their own voluntary contributions to the plan. Moreover, since the employees are contributing to the plan, the amounts contributed by the employer can be considerably less than would be needed if the employer were paying the entire cost (as under most conventional pension plans). The employer only needs to contribute enough to provide a "match" sufficient to induce participation by enough employees to meet the law's coverage and nondiscrimination requirements.

Few employers have difficulty meeting either current or proposed coverage and nondiscrimination tests. There are typically enough "second earners" looking for a tax shelter and older employees whose other financial obligations have been largely met. (Unfortunately, for all too many of these older employees, the 401(k) savings are "too little, too late.")

We do support voluntary saving for retirement for those who can afford it. But we continue to believe that for workers at the lower end of the wage scale, traditional employer sponsored and employer paid pension plans have the greatest potential for delivering adequate retirement benefits. This potential is not likely to be realized as long as the tremendously popular 401(k) plans are competing for the same pension dollars. Rather than making improvements in their conventional pension plans, employers will increasingly rely on these do-it-yourself savings arrangements simply because they are cheaper.

The danger is that the protections now provided to lower income and lower middle income workers by conventional pension plans will decrease over time. These are the workers who simply cannot afford to save for themselves early enough or in sufficiently large amounts to provide the steady stream of income they will need to supplement social security in retirement. To protect these workers - the workers that we believe Congress intended to protect through the tax-favored treatment provided to retirement plans - we urge you to reconsider the bill's provisions preserving 401(k) plans.

B. Minimum benefits for retirement plans. Under the bill, an employer who wants to set up a so-called "non-retirement" plan must also have a "retirement" plan, that provides a certain minimum benefit. The reason given for this requirement is to prevent an employer from using the retirement plan to pay only token benefits, while using the non-retirement plan to pay substantial benefits to high salaried employees. But the minimum benefit is not enough,in itself, to provide lower-income workers an adequate supplement to social security. Neither is there any incentive for employers to give workers more than the minimum.

The required minimum adds up to a benefit of one-half of one percent of compensation per year of service in a defined benefit plan, or a contribution of three percent of compensation per year in a defined contribution plan. For example, a worker with 20 years of service and earnings of $20,000 would have to be paid only $167 a month by a defined benefit plan.

We urge you to consider requiring more than 1% as a minimum benefit. According to the Bureau of Labor Statistics, 62% of participants in nonintegrated final pay plans of medium and large firms have benefit formulas providing 1.25% or more of final pay. We also urge you to clarify that any specified minimum refers to an amount after any integration formula is applied.

II. The bill eliminates some of the most egregious abuses of the private pension system. It also creates new inequities and fails to address some outdated concepts underlying the system.

A. Coverage and participation. The bill requires that an employer maintaining a retirement plan for employees in a single line of business must offer all employees earning less than the social security wage base an opportunity to participate in that plan or another retirement plan. This provision would largely eliminate the practice of excluding workers by job category and is extremely important for that reason. But it would also invite employers to exclude higher paid employees from retirement plans. We think this is both unnecessary and undesirable.

In the past, the single most important factor in benefit improvements in conventional pension plans has been that higher-paid employees could benefit from plan improvements only if they also provided the improvements to the lower-paid. This "trickle down" phenomenon is important and should be retained by requiring an employer to offer pension participation to all employees in a single line of business.

We also do not support the concept of permitting an employer to satisfy the coverage tests by offering participants the opportunity to join one of two or more retirement plans. This could lead to a situation where lower paid employees would participate in an inadequate pension plan while primarily higher-paid employees take advantage of a far more generous 401(k) retirement plan. There appears to be no requirement of comparability of plans and this provision seems open to abuse.

B. Vesting. S. 1784 would institute a major pension reform by reducing the vesting requirement from ten to five years. One of the most common complaints we receive from individuals concerns vesting. The ten-year vesting requirement of the typical pension plan is impossible for many workers to meet, either because they are laid off, because they leave for family responsibilities, or because they must change jobs in order to advance.

We believe that this change in vesting is essential if the majority of today's workers are to have any hope of collecting a pension. For this reason, we ask you to apply this requirement to all plans, without any exceptions for multi-employer plans. Many of the workers who tell us they could not vest are members of these plans who were laid off through no fault of their own and cannot find another job in the same industry.

Our impression is that few workers in multiemployer plans leave voluntarily after their 5th year of work. They are generally skilled in their trade or craft by that time and are loyal union members. For them, as for other workers, the forfeiture of their pension can mean the loss of pension credit for up to one-fourth of their work lives.

They are particularly outraged--and bewildered--by the loss of their benefits. "What happened to my money" is a repeated refrain in the letters of workers who have lost benefits under multiemployer plans. They have been told after each union contract exactly how much money will be put in the pension fund for each hour they work. They feel they have earned that money.

We have seen no evidence that would justify creating a different set of rules for multiemployer plans. Possibly there was a time when it was up to an employee to decide whether he or she would stay within employment covered by a plan. That situation no longer exists. Now participants in multiemployer plans tell us that they need just as much protection as any other worker.

If there are some multi-employer plans that truly could not afford to reduce vesting within the five year period specified by S.1784, then we suggest permitting a temporary exception as is now provided by Section 207 of ERISA.

C. Integration. S.1784 tackles one of the most complex--and most inequitable--of all pension practices, pension integration. Integration is a sophisticated way for pension plans to provide disproportionately large benefits to higher-paid employees at the expense of the lower-paid. The bill would put a stop to the most abusive of all pension integration practices, the elimination of a worker's entire pension benefit by directly or indirectly subtracting a portion of his or her social security benefits. The bill provides that integrated retirement plans must provide participants with at least one-half of the pension they have earned under the plan.

While this is an extremely important reform, we are concerned that it remedies only the most extreme integration abuses and leaves untouched other integration practices that workers and retirees perceive as fundamentally unfair. These practices are likely to become even more entrenched and more pervasive if they are ratified by the enactment of this legislation.

We are troubled by the fact that pension integraton is based on concepts that are outdated and no longer tenable. For example, pension integration practices date back to an era when pensions were thought of as gifts or rewards for loyal employees. While it may have been appropriate at that time to provide pension benefits primarily to higher-paid employees, workers now view pensions as benefits that they have earned and that are essential to supplement their social security checks.

Similarly, the principal rationale for pension integration is that social security is weighted in favor of lower-paid workers and, therefore, it is proper to remedy this "discrimination" against higher paid workers by skewing pension benefits in favor of higher-paid workers. Yet this rationale fails to take into account the fact that higher-paid workers receive very substantial amounts of income from savings and investments whereas lower-paid workers receive little or nothing from these sources. The savings income of the higher-paid more than remedies the "tilt" in social security.

Another, related, rationale is that lower-paid and higher-paid workers should have roughly the same percentage of their pre-retirement income replaced by a combination of social security and pension income. What is curious about this concept is that it seems to suggest that a basic purpose of the private pension system is to enable higher income workers maintain their pre-retirement standard of living. We question whether this is, in fact, a central purpose of the system. It is certainly not the reason for the enormous tax subsidy to the private pension system. That is meant to provide employers with tax incentives designed to encourage them to provide an adequate income for lower and moderate income employees. Stated differently, while the higher replacement rate for higher-paid workers that results from pension integration may be needed as a "carrot" to encourage employers to set up and contribute to pension plans for their rank and file workers, the purpose of the system is not to provide that higher replacement rate.

We urge this Subcommittee to take a careful look at pension integration in light of present day realities. If you find that the old concepts no longer apply and that the real, bottom line, reason for pension integration is simply that some employers will not want pension plans if they cannot pay off primarily to the higher-paid, we submit that you should consider exploring other "carrots" that may be equally attractive to employers but are fairer to employees, more straightforward in their operation and, most important, achieve the objective of providing an adequate pension for those most in need of a social security supplement. The pension proposals in S.1784, while far simpler than current rules, are not likely to be viewed favorably by employees. The offset formula in particular is likely to be perceived as one hand giving what the other takes away. Workers will be told that on the one hand they've earned a pension benefit, but on the other that half of it has been taken away.

III. The bill encourages the use of SEPs in small companies but it also incorporates a voluntary savings feature that could diminish pension protection for rank and file employees.

S.1784 recognizes that one of the fundamental reasons that workers do not end up with pensions is that52% of private sector workers are not even included in pension plans. The bill acknowledges that one way to encourage plan establishment is through Simplified Employee Plans. We are pleased that the bill prohibits the use of pension integration in SEPs.

However, we are concerned that the bill will allow small employers, those with 25 or fewer employees, to turn this secure plan arrangement into a 401(k) plan.

As we previously noted, 401(k) plans transfer the responsibility of providing adequate pensions from the employer to the employee. Thus, rather than making fair and substantial contributions to each employee, the employer will be able to "match" contributions of those who voluntarily put money into the 401(k)-SEP. Again, it will be the lower-paid who cannot afford to contribute who will be short-changed.

A Simplified Employee Plan has a lot of merit on its own. We are not convinced that any additional incentives are needed to encourage employers to set them up. The reason so few employers now have them is that practically no one knows about them. We are certain this will change as financial institutions and organizations begin promoting them as a viable alternative to more costly traditional plans.

Moreover, if employer incentives are needed beyond the $30,000 contribution limit, one idea might be to allow employers to make contributions for all the years they worked for the company before the establishment of the plan. This appears to us to be the best "carrot" you could offer.

Conclusion. We appreciate the chance to present our views on S. 1784. In addition to strengthening the provisions the bill already contains, we urge you to consider additional protections, such as those contained in S.1169, the Economic Equity Act, that would enhance the retirement income security of many parttime and older workers who are now denied the opportunity to participate and earn benefit credits in many pension plans. We also ask that the Subcommittee consider studying the feasibility of providing a measure of cost of living protection for retirees in overfunded plans and focus attention on changes in ERISA that would make it easier for participants to enforce their pension rights.

I would be pleased to answer any questions you may have.

STATEMENT OF DR. MARY GRAY, NATIONAL PRESIDENT, WOMEN'S EQUITY ACTION LEAGUE; AND PROFESSOR, MATH, COMPUTER SCIENCES AND STATISTICS DEPARTMENT, AMERICAN UNIVERSITY, WASHINGTON, DC

Senator HEINZ. Dr. Gray.

Dr. GRAY. Thank you, Senator Heinz.

I am Dr. Mary W. Gray, Professor of Mathematics, Statistics and Computer Science at American University. I am also an attorney dedicated to the passage and enforcement of equal opportunity laws for women and minorities.

I have spent much of the last 15 years of my personal and professional life working toward pension equity for women. Therefore, I am especially privileged and delighted to appear before you today as National President of Women's Equity Action League, a national membership organization specializing in women's economic issues.

Since its beginning in 1968, WEAL's research, education, litigation and advocacy have been directed toward the improvement of the nation's retirement system.

We would like to applaud you for introducing this bill. It builds on and strengthens previous private pension reform. The most recent legislation, the Retirement Equity Act, gave millions of ex-spouses and young workers access to pension coverage and benefits. While additional reforms for spouses are still needed, today's focus is on the worker and the private sector.

Several earlier witnesses complained about the constant changing of pension laws. However, the fact of the matter is that dramatic changes in the work force tend to outdate our pension laws almost as fast as they are enacted. Few families can survive on one earner's salary. Few workers stay at the same job throughout a lifetime. New technologies require retraining and mobility. Increases in cost of living, divorces, life expectancies have all the potential for leaving millions of workers, especially women, inadequately prepared for and economically unprotected in their retirement years.

Why, you might ask, do we insist that pension reform is a women's issue. It is because elderly women are the poorest of our nation's poor. Half of all elderly women are single and half of the single elderly women live at or near the poverty level. Of all elderly people living alone and in poverty, four out of five are women. Only 11½ percent of the women over 65 have a private pension, either their own or as a surviving spouse.

Social Security is not enough. In 1985, the average monthly Social Security benefit for elderly women was $311. This is compared to $527.00 for elderly men, which is itself hardly enough.

The median annual income in 1983 for elderly women from all sources was $5,599, compared to nearly $10,000 for elderly men. Again, it may not be enough for men, but it is considerably worse for women.

What, do you ask, do we propose as policy remedies to improve women's retirement security. Well, one of the things we could do is encourage male spouses to take better care of themselves so they would live longer and the women would not have to live alone on reduced benefits. We could close the wage gap between men and women's salary. We could eradicate job segregation. All of those things need to be addressed, but most importantly, we could pass the Retirement Income Policy Act.

Senator Heinz. There is one other solution, you know, which is to have women marry younger men. [Laughter.]

Dr. **Gray**. That is certainly true.

Senator **Heinz**. As long as they don't smoke.

Dr. **Gray**. Well, if we could get the men to stop smoking, I would not want the women to start smoking in exchange for that.

But, nonetheless, it certainly would help. We do not think anyone should be killing himself or herself off too rapidly.

The combined retirement incomes will help everyone.

We think that the vesting requirements of the Retirement Income Policy Act are very important because of the higher mobility of women in the work force and the fact that otherwise they will be deprived of a lot of benefits that they might have.

We think that the most important thing is to increase the coverage. And we think that this bill is a good start in that direction.

Senator **Heinz**. Dr. Gray, thank you very much.

[The prepared written statement of Dr. Gray follows:]

TESTIMONY PRESENTED BY DR. MARY W. GRAY, NATIONAL PRESIDENT, WOMEN'S EQUITY ACTION LEAGUE

January 28, 1986

A SUMMARY of the presentation by Dr. Mary Gray, National President of the Women's Equity Action League, before the Senate Committee on Finance's Subcommittee on Savings, Pensions and Investment Policy about S. 1784, The Retirement Income Policy Act.

WEAL applauds Senator Heinz for introducing the "RIP" legislation and is pleased to participate in the Finance Committee's reassessment of the nation's private pension policy.

RIP builds upon and strengthens previous reforms in private pensions, especially last session's Retirement Equity Act where a million ex-spouses and young workers gained access to pension rights. Some improvements for widows and divorced spouses still need to be enacted, but today's discussions center around reform for workers in the private sector.

The Bureau of Labor Statistics tells us that in 1983, 74.1 million workers received wages or salaries in the private sector. Almost 44 million of these workers (59%) DO NOT PARTICIPATE in a private pension plan. Of the 30 million workers who are participating, only half have fulfilled the vesting requirements for receiving the benefits of their pension. That adds up to almost 59 million workers in the private sector who have no pension or who do not (as yet) have the right to receive their pension.

S. 1784 is an important step towards improving the pension prospects for these 59 million workers.

1. The RIP Act reduces vesting requirements from 10 down to 5 years. That

is essential. Sadly, it exempts multiemployer plans and does not provide coverage or vesting credit for part-time workers who work less than 1,000 hours a year. True reform must not exempt any plans from 5 year vesting and should include part-time workers with 500 hours a year or more.

2. The RIP Act expands pension coverage by requiring coverage for every employee with earnings less than the Social Security taxable wage base[1] ($42,000 in 1986). Sadly, it does not extend coverage or credit to older workers, either those who begin work within 5 years of normal retirement or those who continue to work after 65. Coverage should be extended to these workers.

3. The RIP Act attempts to restrict the practice of integration, but falls short of remedying the problem of the "disappearing pension." Ideally, integration should be eliminated, but at the very least there should be a minimum pension benefit. Integration formulas should be simplified and employers should be required to explain the procedure to the workers. The House tax bill precludes small companies from subtracting Social Security earnings from prior employment and also calls for Congress to study the whole question of integration. The Senate Finance Committee should do no less and should certainly look into how formulas affect different workers and if they are beneficial or discriminatory to workers at all levels of earnings.

4. The RIP Act proposes improvements in pension portability by requiring a penison plan to deposit lump sum payments directly into an IRA for a worker under age 59 and a half, rather than the current practice of turning over the sum without strings. Fewer than 5% of the workers who receive lump sums invest the money in pension savings currently. Improvements to this section would also help workers who have shorter job tenure by giving them the right to request the lump sum payment if the vested pension benefit is worth 7,000 or less.

5. The RIP Act discusses SEPPs (Simplified Employee Pension Plans), which are important and easy ways for small employers to provide pensions without

formal plans. RIP says that SEPPs may not be integrated with Social Security (good), but limits their use to employers with 25 or fewer employees. This limit is arbitrary and discourages employers with NO pension plan from setting up a SEPP if they expect to ever have 25 or more workers. SEPPs should be as available as possible.

WEAL, along with the many other national membership organizations who support pension reform, hopes that you will incorporate our suggestions into the final legislative package that you pass. Why? Because the economic security of women and their families depends on it.

o Elderly women are the poorest of our nation's poor. Their poverty rate is 15% compared to 8.7% for elderly men. Half of all elderly women are single, and half of the single elderly women live at or near the poverty level. Of all elderly people living alone and in poverty, 4 out of 5 are women. THEY HAVE NO PENSION. Only 11.5% of the women over 65 have a private pension, either their own or as a surviving spouse. They live mostly on Social Security and in 1985 the average monthly Social Security benefit for elderly women was $311, compared to $527 for elderly men. The median annual income in 1983 for elderly women FROM ALL SOURCES was $5,599, compared to $9,766 for elderly men.

Private pension inequities that women face can be remedied several ways.

a. Male spouses can be required to live longer so that women are not left alone old and impoverished.

b. The wage gap between men's and women's earnings can be closed, since pre-retirement income determines retirement benefits. Currently, women earn barely 63 cents to the men's $1. The Rand Corporation estimates that by the year 2000 women will earn at least 70 cents to the dollar, but this is still a major shortfall when added up over a lifetime of wage earning.

c. The job segregation that women face can be eradicated. Currently, the majority of women who work can be found in only a handful of occupations and these are the jobs that pay the least. Advances out of these "ghettos" are occuring, but are slow and estimates predict only a 1 - 6% decline in occupational segregation through 1990. Simply getting a job will not be the answer to women's retirement needs. The majority of new jobs expected through 1995 are in heavily segregated, mostly female, occupations. The 3.3 million women who joined the workforce between 1979 and 1983 prove our case. Only 20% of these new working women found jobs where they were covered by a pension plan. Even coverage doesn't guarantee the right to participate if women work fewer than 1,000 hours, are part of a legally "excluded" class, are 60 or older when they start work, or choose to work past 65.

d. Private pension reform can be enacted.

1) Coverage must be increased. Of the 32.3 million women in the private workforce, only one-third participate in pensions. 8.6 million of the 32.3 million women work part-time, and only 10% of these part-time working women participated in a pension plan in 1983. Men will benefit from increased coverage, since only 47% of the 41.9 million men in the private workforce participate in pensions.

years will help everyone. According to the Employee Benefit Research Institute, if 5 year vesting were in place in 1985, 1.9 million more workers would have been entitled to pension benefits and there would have been a 10% gain in the number of vested women workers.

3) Integration should be eliminated or severly curtailed. Low-earning workers, mostly women, often find themselves left with little or no pension after their Social Security benefits have been subtracted.

4) Portability must be encouraged. The mobile work patterns of both men and women workers makes this a necessity. A system of portability would no longer penalize women for their shorter job tenure and sporadic workforce participation and would enable pension funds to be accumulated and earn more for the worker rather than remain frozen in plans at low amounts and low interest.

5) All efforts should be made to encourage employers to establish even the simplest of pension plans for their workers. For women who work in small businesses, who are non-unionized, who work in struggling businesses or non-profit agencies, even the simplest of pensions is important. Voluntary savings plans must not be allowed to replace pension plans.

Most of all, we must not be hypnotized by the Myth that women's increased labor force participation will translate into commensurate pension coverage and benefit entitlement.

We must look closer at assertions that the elderly are doing better than ever. One half of the elderly women who live alone face poverty every day and the picture will continue to be bleak even if women work for wages from the time they are 16 until they reach 64 UNLESS reforms are enacted.

And sadly, women who enter the workforce are NOT demanding pension coverage at the top of their job requirements. They want money to feed and support their families, health insurance, leave time, child and dependent care provisions, and job satisfaction before they seek out retirement benefits. We pledge to continue our educational efforts to encourage women workers to look toward and save for their retirement years. In the meantime, we will work closely with this committee, Senator Heinz and the bill's co-sponsors and the many supporters in the House and in the advocacy community to enact private pension reform for the millions of workers who lack retirement security.

STATEMENT OF DR. WILLIAM S. HOFFMAN, DIRECTOR, SOCIAL SECURITY DEPARTMENT, INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA, DETROIT, MI, ACCOMPANIED BY ALAN V. REUTHER, ASSOCIATE GENERAL COUNSEL, UAW, WASHINGTON, DC

Senator HEINZ. Dr. Hoffman.

Dr. HOFFMAN. Thank you, Senator.

I am Bill Hoffman, Director of the Social Security Department of the UAW. Accompanying me today is Alan Reuther, our associate general counsel.

We appreciate this opportunity to testify today on the Retirement Income Policy Act of 1985. Our Nation's retirement income policy is of vital concern to the 1½ million active and retired members of the UAW and their families, most of whom are covered under negotiated defined benefit pension plans.

The UAW strongly supports S. 1784. We appreciate your leadership, Senator, in developing this important legislation.

S. 1784 deals with the private pension system and its role in providing adequate supplements to Social Security retirement benefits. The UAW has long held that Social Security should be the universal and fundamental source of retirement income for all Americans. However, Social Security benefits alone fall far short of providing the income necessary to maintain a comfortable standard of living for the great majority of retirement persons.

We have also long maintained that employer-sponsored retirement programs are the most effective vehicles for providing the retirement income that is needed to supplement Social Security benefits. We, therefore, believe that the existing system of employer-sponsored retirement plans should be retained, and the growth of these plans should be encouraged.

By establishing and clearly articulating a comprehensive and fair national retirement income policy with simple, uniform and stable ground rules, S. 1784 will help create the type of climate that will encourage employers to establish and maintain private pension plans. The new coverage and vesting provisions, stricter Social Security integration requirements and tightened distribution rules would also help assure that a greater portion of the work force actually receives retirement benefits under employer-sponsored pension plans.

The UAW supports the provisions which would establish a clear distinction between retirement and non-retirement plans. Present pension law is very confused in this area, and it is important that this distinction be made. We especially support the provisions of the bill which would require employers to provide a substantial retirement plan to employees before a non-retirement savings plan may be offered to them.

We also favor the provisions which would curtail the tax preferences for non-retirement savings plans.

Together, these provisions would redirect and focus the Federal Government's tax expenditures on the important objective of encouraging the growth and development of employer-sponsored plans that will provide participants with retirement income to supplement the Social Security.

We support the provisions which would help ensure that distributions from pension plans are actually used to provide retirement income.

We also support the provisions that would assure retirement plans do not discriminate against lower-income employees by requiring an employer that maintains a retirement plan for any employee to cover all employees who earn less than the Social Security taxable wage base.

We support reforming the rules relating to integration of private pension benefits with Social Security.

We are also encouraged by provisions of 1784 which would reduce the maximum contributions to 401(k) plans but also offset allowable IRA contributions.

Finally, the UAW is committed to reforms that will helo the private pension system be more responsive to those workers who spend not all of their or most of their working careers with one employer.

We support the shortening of the vesting period, but shortening it is not enough. This only provides for fixed amounts of benefits later on in retirement. We believe that we should look towards a total system of pension portability, perhaps within one industry at a time or perhaps for all government contractors. I believe that pension portability on that basis will go further than permitting just the withdrawal of accumulated benefits.

Senator, thank you for the opportunity today.

Senator HEINZ. Dr. Hoffman, thank you.

[The prepared written statement of Dr. Hoffman follows:]

STATEMENT OF WILLIAM S. HOFFMAN, PH.D., DIRECTOR, SOCIAL SECURITY DEPARTMENT, INTERNATIONAL UNION, UAW, ON THE RETIREMENT INCOME POLICY ACT OF 1985 (S. 1784)

Mr. Chairman, I am William S. Hoffman, Director of the Social Security Department of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). The UAW appreciates the opportunity to testify before this Subcommittee concerning the proposed "Retirement Income Policy Act of 1985" (S.1784). Our nation's retirement income policy is of vital concern to the 1.5 million active and retired members of the UAW and their families, most of whom are covered under negotiated defined benefit pension plans.

The UAW strongly supports S.1784. We commend the Chairman of this Subcommitte, Senator Heinz, for his role in developing this important legislation.

S.1784 deals primarily with the private pension system, and its role in providing adequate supplements to Social Security retirement benefits. The UAW has long held that Social Security should be the universal and fundamental source of retirement income for all Americans. However, Social Security benefits alone fall far short of providing the income necessary to maintain a comfortable standard of living for the great majority of retired Americans. The UAW has also long maintained that employer-sponsored retirement programs are the most effective vehicles for providing the retirement income that is needed to supplement Social Security benefits. We therefore believe that the existing system of employer-sponsored retirement plans should be retained and that the growth of these plans should be encouraged.

By establishing and clearly articulating a comprehensive and fair national retirement income policy, with simple, uniform, and relatively stable ground rules, S.1784 would help to create the type of climate that will encourage employers to establish and maintain private pension plans. The new coverage and vesting provisions, stricter Social Security integration requirements, and tightened distribution rules would also help assure that a greater portion of the workforce actually receives retirement benefits under employer-sponsored pension plans.

In the past, Congress has too often been motivated by budget or tax considerations when making changes in the laws governing private pension plans. The UAW submits that it is time to establish a comprehensive, equitable, and stable national retirement income policy. The tax reform bill that was passed by the House at the end of the last session contains numerous provisions dealing with private pension plans. Although most of these provisions represent an improvement over current law, the UAW believes that S.1784 addresses retirement income policy issues in a much more comprehensive and balanced manner. Accordingly, the UAW urges Members of the Senate Finance Committee to consider substituting the provisions of S.1784 for the House-passed pension provisions when the Committee begins marking up the tax reform legislation.

Most importantly, the UAW supports the provisions of S.1784 which would establish a clear distinction between retirement and non-retirement savings plans. Present pension law is very confused in this area, and it is important that this distinction be made. We especially support the provisions of the bill which would require employers to provide a substantial retirement plan to employees before a non-retirement savings plan may be offered to them. We also favor the provisions which would curtail the tax preferences for non-retirement savings plans. Together these provisions would redirect and focus the Federal government's tax expenditures on the important objective of encouraging the growth and development of employer-sponsored plans that will provide participants with retirement income to supplement the benefits provided under Social Security.

The UAW also supports the provisions of S.1784 which would help to insure that distributions from pension plans are actually used to provide retirement income. Eliminating ten-year income averaging and capital gains tax treatment for lump-sum distributions, requiring early distributions from retirement plans to be rolled over into another qualified retirement plan or an IRA, and increasing the penalty on early distributions from IRAs will discourage the use of retirement funds for purposes other than providing retirement income.

In addition, the UAW supports the provisions of this bill which would assure that retirement plans do not discriminate against lower-income employees. We strongly believe that tax preferences for private pension plans should be made contingent upon stringent anti-discrimination rules, which insure that benefits are broadly distributed to all employees, not just a few upper income executives. We therefore support the provisions of the bill which require an employer (or subdivision of an employer) that maintains a retirement plan for any employees to cover all employees who earn less than the Social Security taxable wage base under a retirement plan. The tax code provides significant tax preferences to private pension plans in order to encourage employers to provide retirement income benefits to their employees. Under current law, however, an employer may exclude 30% or more of employees from coverage. S.1784 would correct this injustice.

The UAW also supports the provisions of S.1784 reforming the rules relating to the integration of private pension benefits with Social Security. In addition to being overly complex, the current integration rules permit employers to structure their plans so that benefits flow disproportionately to higher wage earners, while the lower-paid employees may receive little or no benefits. The integration provisions of this bill would assure that pension benefits are more evenly distributed throughout the workforce, and that all workers receive some benefits under a plan.

We are also pleased to see that S.1784 would lower the maximum contributions permitted under defined contribution plans. We strongly believe that defined benefit pension plans are the best vehicles for providing, in combination with Social Security benefits, a secure and adequate retirement income. These plans have the distinct advantage of making known to future pensioners the amount of income that will be available to them upon retirement. Moreover, only defined benefit plans possess the flexibility needed to provide essential benefits, including meaningful surviving spouse pensions, early retirement supplements, adequate disability income and post-retirement benefit increases.

On the other hand, defined contribution plans, which are simply used to accumulate amounts in individual accounts belonging to each worker, have a number of drawbacks. The level of funds in any individual's account is a function not only of the level of plan contributions, but also of the plan's investment performance. Due to the variability of investment performance, the luck of the draw frequently determines an employee's retirement income. Furthermore, the accumulated account balance will always be too small to provide an adequate retirement income for the worker who begins participating in the plan late in his or her working career. Also, too often a retiree's accumulated account balance is looked upon as an economic windfall, and is not actually used to provide retirement income. Even when the account balance is used to provide retirement income, it is difficult to provide for post-retirement increases. For these reasons, defined contribution plans are less effective than defined benefit plans in assuring retirement income security.

Currently the maximum contribution limits under defined contribution plans allow a greater benefit to be paid from a defined contribution plan than could be provided under a defined benefit plan. This bill would more nearly equalize the maximum benefits available from the two types of plans. This is a significant step in the right direction, although we believe that a better approach would be to provide even lower maximum contribution limitations under defined contribution plans in recognition of their disadvantages as retirement income vehicles.

Along the same line, we are also encouraged by provisions of S.1784 which would reduce the maximum contributions to 401(k) plans and would also offset allowable IRA contributions by the amount of 401(k) contributions. 401(k) plans are defined contribution plans, and as such contain the drawbacks previously mentioned. They also have the additional drawback of being discriminatory, since higher income employees, with their higher marginal tax rates and greater level of discretionary income, are more able to benefit from the tax-deferral features of these plans.

In addition to the provisions of this bill, we would support measures to tighten the utilization and discrimination rules for 401(k) plans. Unlike traditional types of retirement income plans, under a 401(k) plan there is no requirement that all employees actually participate in the plan. Often, employers make matching contributions for those employees who decide to contribute to the plan via salary reduction. Although the plan must satisfy a utilization test, the employer still is not required to make contributions on behalf of all employees, and all employees do not have to participate in the salary reduction program. In our judgment, this represents a bad precedent, and runs counter to efforts to assure greater worker participation under the private pension system.

Finally, the UAW is committed to reforms which will help to make the private pension system more responsive to the needs of those workers who do not spend all or most of their working careers with one employer. Currently, a typical pension plan provides that benefits do not become vested until an employee has been a plan participant for ten years. We are pleased with the provision in S.1784 that would lower this requirement to five years for single-employer plans. This change would result in greater retirement benefits for employees who work for many employers during their working career, or else move in and out of the workforce.

But shortening the vesting period is not enough. Workers who satisfy the vesting requirements still will only qualify for a benefit that is fixed in amount when employment is terminated. Their benefits then suffer from steadily eroding purchasing power. More liberal vesting without benefit improvements subsequent to termination would be of rather limited value; although more workers would qualify for benefits, those benefits would be based on frozen amounts for short periods of service. Furthermore, eligibility for other employment related retirement benefits, such as health care and life insurance, are not provided to those only eligible for deferred vested benefits.

The establishment of a procedure allowing for the portability of private pension credits is needed in order to provide substantial improvements in retirement security for American workers. Such a reform would recognize the hard economic fact that America has a highly mobile workforce. It would also take note of the fact that this mobility is increasingly involuntary as workers are exposed to the severe social and economic dislocation triggered by plant closings and runaway shops. These workers are twice penalized — once when they are uprooted by circumstances beyond their control, and then again when they ultimately receive diminished retirement benefits. Carrying pension service from one employer to another can be a workable solution to this problem. In fashioning a solution to this problem of benefit erosion, we urge Congress to develop a system allocating the costs of such protection so that employers pay their fair share. Employers gain tremendously from our economic system which encourages labor mobility, and it is only proper that workers be protected from the economic penalities of that increasing job mobility.

We recognize the development of such a program will need to address the issue of eligibility, benefit levels, funding mechanisms and administration. Yet these are not insurmountable tasks. A national private pension portability program could be established in stages. It could develop within industries and later be extended between industries. Another approach would be to require pension portability among employers receiving government contracts, starting perhaps in the defense industry. Our union has already proposed such a program to several employers in the aerospace industry.

In conclusion, the UAW would again like to commend you, Mr. Chairman, for your efforts in developing S.1784. In our judgment, this bill goes a long way towards providing the kind of reasoned national retirement income policy our nation has needed for many years. We look forward to working with you in the struggle to achieve a national retirement income policy that will encourage the growth and development of private pension plans and thereby improve the retirement income security of all Americans. Thank you.

STATEMENT OF WILLIAM B. WELSH, DIRECTOR OF LEGISLATION, ACCOMPANIED BY CHARLES M. LOVELESS, LEGISLATIVE AFFAIRS SPECIALIST, AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES, WASHINGTON, DC

Senator HEINZ. Mr. Welsh.

Mr. WELSH. Mr. Chairman, I am Bill Welsh, the Director of Legislation of the American Federation of State, County and Municipal Employees; and I am accompanied by Chuck Loveless, who is on the legislative staff and concentrates on pension retirement issues.

We want to commend you and the others for sponsoring this legislation. And we have in our written statement outlined a number of the provisions that we think are most important.

What we would like to concentrate on today is the fact that we regret that S. 1784, as currently worded, excludes from coverage under most of its substantive provisions pension plans sponsored by State and local governments.

In our view, an essential component of a national retirement income policy must be the enactment of certain minimum standards for State and local government employee retirement systems. And we would respectfully urge that the subcommittee not neglect the concerns of the more than 13 million active and retired state and local government workers as it considers the many important issues relating to the development of such a policy.

Unlike their counterparts in the private sector who are protected by ERISA and in the Federal sector who have comparable protections, State and local government workers have virtually no federal retirement income protections. It does not seem an unusual notion that important pension plan information should be disclosed to participants; that the assets of any plan belong to its participants and that they should be invested for the exclusive benefit of the participants and beneficiaries; and that the individuals who control those assets should be held under the law to a high standard of behavior.

In fact, all of this is the case in the private and federal sectors. Unfortunately, it is by no means a settled proposition in the State and local government sector. Conflicting and ambiguous State and local laws and court decisions have created much uncertainty about the legal rights of participants of State and local government pension plans. Virtually every major study of State and local plan reporting and disclosure practices has found serious shortcomings, including a recent one conducted by the former director of the President's Pension Policy Commission which we have attached to our written statement. The result has been that such systems are not operated in accordance with generally accepted financial and accounting practices which have long been applicable to private and federally sponsored plans.

Due to the absence of meaningful reporting and disclosure requirements, few pension plan participants have a realistic assessment of their pension entitlements or of the strength and weaknesses of the retirement system. Moreover, it should be emphasized that the lack of regular, systematic reporting and disclosure practices does not merely pose a problem for plan participants and beneficiaries; taxpayers, investors and even Government officials are kept in the dark regarding the true costs and investment practices of the plans.

As a constructive means of addressing the public pension crisis AFSCME strongly supports the enactment of uniform standards of reporting and disclosure and of fiduciary conduct for State and local government retirement systems. We urge the subcommittee to consider incorporating such standards in S. 1784. Now, more than a decade after the enactment of ERISA, it is time to adopt legislation along the lines of H.R. 3126, the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA), introduced by the ranking bipartisan leadership of the House Committee on Education and Labor. Similar legislation has previously been introduced in the Senate by Senator Chafee.

It should be emphasized that PEPPRA is not intended as a substitute for State and local pension reform efforts. Instead, it is designed to provide public officials, taxpayers and employee representatives with the tools necessary to intelligently assess State and local pension issues and to serve as a catalyst for reform at the local and state level.

Thank you very much, Mr. Chairman.

Senator HEINZ. Thank you very much, Mr. Welsh.

[The prepared written statement of Mr. Welsh follows:]

STATEMENT OF THE AMERICAN FEDERATION OF STATE, COUNTY AND MUNICIPAL EMPLOYEES ON S. 1784, THE RETIREMENT INCOME POLICY ACT

Chairman Heinz and distinguished members of the Subcommittee on Savings, Pensions and Investment Policy, I am William B. Welsh, Director of Legislation of the American Federation of State, County and Municipal Employees (AFSCME). I am accompanied by Charles M. Loveless of AFSCME's Department of Legislation. We are appearing today on behalf of the more than one million members of AFSCME who work for state and local governments across the nation.

We would like to commend the Chairman and members of the Subcommittee for holding this hearing focusing on the need for a federal retirement income policy. Certainly, there is a pressing need to develop and implement a coordinated and comprehensive national retirement income and employee benefit policy. The 1981 final report of the President's Commission on Pension Policy (the Commission) and numerous other studies have found serious deficiencies to exist in such programs.

S. 1784, the Retirement Income Policy Act of 1985, introduced by Senators Heinz and Chafee, would take several major steps toward developing a coherent national retirement income policy and enhancing the retirement income security of millions of Americans. By shortening the period of service required for vesting and modifying the integration rules to prevent employers from eliminating pension benefits for lower-paid workers, S. 1784 would significantly improve the prospect that participants covered under a plan will actually receive benefits. Moreover, by establishing procedures encouraging small employers to adopt simplified employer plans, the legislation should increase the number of employees covered under private pension plans.

However, we regret that S. 1784, as currently worded, excludes from coverage under most of its substantive provisions pension plans sponsored by state and local governments. In our view, an essential component of a national retirement income policy must be the enactment of certain minimum standards for state and local government employee retirement systems. We would respectfully urge that the Subcommittee not neglect the concerns of the more than thirteen million active and retired state and local government workers as it considers the many important issues relating to the development of such a policy.

Unlike their counterparts in the private sector who are protected by ERISA and in the federal sector who have comparable protections, state and local government workers have virtually no federal retirement income protections. It does not seem an unusual notion that important pension plan information should be disclosed to participants, that the assets of any plan "belong" to its participants, that they should be invested for the "exclusive benefit" of the participants and beneficiaries and that the individuals who control those assets should be held under the law to a high standard of behavior. In fact, all this is the case in the private sector. Unfortunately, it is by no means a settled proposition in the state and local government sector. Conflicting and ambiguous state and local laws, if any exist, and court decisions have created much uncertainty about the legal rights of participants in state and local government pension plans.

Currently, the pension funds for state and local government employees hold over $260 billion in assets. They are predicted to grow at a rate of nearly $30 billion per year for the next five years. These pension funds are an important source of investment capital for the states in which they are located and the nation on a whole. Yet the management of these funds is often characterized by conflict of interest, restrictive state laws, political manipulation and unprofessional portfolio management. Attempts at reform are too often thwarted by local business or political interests.

Virtually every major study of state and local plan reporting and disclosure practices has found serious shortcomings. The result has been that such systems are not operated in accordance with generally accepted financial and accounting practices which have long been applicable to private and federally sponsored plans. Due to the absence of meaningful reporting and disclosure requirements, few pension plan participants have a realistic assessment of their pension entitlements or of the strengths and weaknesses of their retirement systems. Moreover, it should be emphasized that the lack of regular, systematic reporting and disclosure practices does not merely pose a problem for plan participants and beneficiaries; taxpayers, investors and even government officials are kept in the dark regarding the true costs and investment practices of the plan.

The scope of the crisis confronting state and local government pension plans is graphically documented in a recently released report on state and local plans. The study, Dollars and Sense: The Case for State and Local Pension Reform (a major portion is set forth below as Attachment A) was commissioned by AFSCME and prepared by Thomas Woodruff, Executive Director of the President's Commission on Pension Policy. We strongly concur with the central conclusion of the Woodruff report, of the 1978 Pension Task Force Report on Public Employee Retirement Systems of the House Education and Labor Committee and of a host of other public and private studies that current regulations of state and local plans is inadequate and that federal legislation must be enacted to protect the vital national interests involved.

As a constructive means of addressing the public pension crisis, AFSCME strongly supports the enactment of uniform minimum standards of reporting and disclosure and of fiduciary conduct for state and local government retirement systems. We respectfully urge the Subcommittee to consider incorporating such standards in S. 1784. Now more than a decade after the enactment of ERISA, it is time to adopt legislation along the lines of H.R. 3126, the Public Employee Pension Plan Reporting and

Accountability Act (PEPPRA), introduced by the ranking bipartisan leadership of the House Committee on Education and Labor. Similar legislation has previously been introduced in the Senate by Senator Chafee.

It should be emphasized that PEPPRA is not intended as a substitute for state and local pension reform efforts. Instead, it is designed to provide public officials, taxpayers and employee representatives with the tools necessary to intelligently assess state and local pension issues and to serve as a catalyst for reform at the local level.

By focusing exclusively on reporting and disclosure and fiduciary standards, the legislation carefully limits the degree of federal intrusion in state and local government affairs. A state's pension plans can be exempted from the specific reporting and disclosure requirements if the state's own laws are substantially equivalent to the PEPPRA standard. Accordingly, effective reporting and disclosure and fiduciary requirements should ensure that state and local pension problems are solved at home rather than in Washington, D. C.

We thank the members of the Subcommittee for the opportunity to present our views on this issue of fundamental concern to state and local government workers. We would be pleased to answer any questions you may have.

Attachment "A" - Excerpts from Dollars and Sense: The Case for State and Local Pension Reform, Thomas Woodruff (1983), pp. 1-5, 7-23, and 37-39.

ATTACHMENT "A"

DOLLARS AND SENSE:

The Case for State and Local Pension Reform

By Thomas C. Woodruff

Preface

This independent report on state and local government retirement systems by Thomas Woodruff, former Executive Director of the President's Commission on Pension Policy, highlights a serious and troublesome national problem. This report, the report of the Pension Task Force of the House Education and Labor Committee and numerous other public and private studies all underscore one essential fact: our state and local public employee retirement systems are on the brink of a major crisis. The problems threaten more than the fiscal stability of these plans; they threaten as well the many people who depend on public retirement systems for their current or future economic security; and finally, they threaten the basic fiscal integrity of state and local governments.

From our studies of these many reports, we believe that certain conclusions are inescapable:

- Many public pension systems are dangerously underfunded.
- There is no comprehensive and uniform set of legal principles that adequately safeguards the operation of state and local plans.
- Fiduciary protections are far less than they should be; meaningful standards for reporting and disclosure are notable by their absence.
- Until this time, the Federal Government has done little to protect the millions of participants who are affected.

Introduction

Currently, Congress is considering the Public Employee Pension Plan Reporting and Accountability Act (PEPPRA), legislation that would establish reporting, disclosure, and fiduciary standards and administrative and enforcement procedures for this nation's 6,600 state and local pension plans.

Over 13 million retired and active state and local government employees depend on these plans to provide them with income security upon retirement. The absence of uniform standards governing these plans has left the retirement income security of millions of state and local employees in doubt. Moreover, state and local government taxpayers will ultimately pay the price for fund mismanagement.

State and local government employees forgo billions of dollars in wages and other forms of compensation each year in order to participate in these pension plans. But, they do not enjoy the same rights and protections as their counterparts in the private sector.

Currently, the pension funds for state and local employees hold over $260 billion in assets. They are predicted to grow at a rate of nearly $30 billion per year for the next five years. These pension funds are an important source of capital for the states in which they reside and the nation as a whole. Yet the management of these funds is often characterized by conflict of interest, restrictive state laws, political manipulation, and unprofessional portfolio management. Attempts at reform are too often thwarted by local business or political interests.

Unlike their counterparts in the private sector who are protected by ERISA, state and local government workers have virtually no federal retirement income protections. It does not seem an unusual notion that the assets of any pension plan "belong" to its participants, that the assets should be invested for the "exclusive benefit" of the plan's participants and beneficiaries, and that individuals who control those assets should be held under law to a high standard of behavior. In fact, all this is the case in the private sector. Unfortunately, it is by no means a settled proposition in the public sector. Conflicting and ambiguous state and local laws and court decisions have created much uncertainty about the legal rights of participants in public pension plans.

As a constructive means of addressing the public pension crisis, the American Federation of State, County and Municipal Employees (AFSCME) strongly supports the enactment of minimum federal reporting and disclosure and fiduciary standards or state and local government retirement systems. By focusing n these areas, such legislation will minimize the degree of ederal intrusion in state and local government affairs. Effective eporting and disclosure and fiduciary standards will ensure that tate and local pension problems are solved at home, rather than n Washington, D.C.

At a time when a debate is getting underway on the formation f a national industrial policy and the use of pension assets as an ntegral component of that policy, the enactment of strong eporting and disclosure and fiduciary standards for state and ocal plans becomes even more important.

Gerald McEntee
President
American Federation of State, County
and Municipal Employees.

In its current draft, certain compromises were made to reduce state and local government opposition to PEPPRA's passage. One unfortunate compromise allows governors to exempt plans in their states from the reporting and disclosure requirements if state or local laws or regulations are "substantially equivalent" to PEPPRA's. When it comes to disclosing key investment, accounting, and actuarial information, the data must be calculated on the same basis in order to be of any value. Disputes over the meaning of the term "substantially equivalent" could very well render the reporting and disclosure provisions of PEPPRA "substantially useless."

In spite of its deficiencies, PEPPRA represents an important step toward reform of the nation's state and local pension plans. A few key amendments would greatly increase its effectiveness. Involvement of important state and local organizations in the activities of a strengthened Advisory Council on Governmental Plans would ensure that the reform process begun by PEPPRA will continue without further federal intervention. Enactment of the reporting and disclosure standards outlined in the legislation would provide solid guarantees both for plan beneficiaries and for the average taxpayer.

In summary, the following points and conclusions can be made:

- the management of the nation's 6,600 state and local government public employee pension funds often produces conflicts of interests, unprofessional portfolio management and political manipulation.
- there is an absence of uniform reporting and disclosure standards which make evaluations of state and local plans difficult, if not impossible.
- legislation now being considered by the Congress would be an important step in assuring that the policymakers, the taxpayer and the plan beneficiaries in state and local government are fully appraised of financial conditions and the management of public employee plans which hold $260 billion in assets.

PEPPRA does not propose to regulate all aspects of state and local pension plans. Instead, PEPPRA seeks to reform practices of these plans with a minimum of federal intervention. The Act would provide for:

- federal reporting and disclosure standards;
- federal fiduciary standards;
- administrative and Enforcement Procedures; and
- creation of an Advisory Council on Governmental Plans.

Experience with private pension plan regulation has shown that adequate and uniform reporting and disclosure standards are the least intrusive and most effective way to reform pension abuse. Federal standards are necessary to ensure comparability of data from plan to plan and state to state.

PEPPRA seeks to apply the same fiduciary standards found in the Employee Retirement Income Security Act (ERISA) to state and local pension fund management. These standards have proved to be effective in significantly reducing abuse in the management of private pension plan assets. Government sponsors and plan participants would benefit from nearly a decade of case law and enforcement experience if these standards were applied to state and local plans as well.

PEPPRA is silent on many standards important to state and local pension reform: participation, vesting, funding, limits on benefits or contributions, and survivor benefits. In addition, no mention is made of two potentially troublesome public policy issues: plan termination insurance, and social security coverage.

The legislation does provide for the establishment of an Advisory Council on Governmental Plans. In its proposed form, this Council promises to be yet another toothless governmental advisory group. If, however, Congress gave this group independence from the Administration, as well as an adequate staff and budget, the Advisory Council could become a catalyst for continued state and local reform. If the Council were successful in its efforts, further federal action might be unnecessary.

Public Employee Retirement Plans

Public employee retirement plans are extremely diverse. The single most comprehensive study of state and local pension plans remains the report of the House Pension Task Force in 1978. Since that time, a number of other detailed studies have been conducted by several executive branch agencies, the President's Commission on Pension Policy, and a number of state and local organizations. In general, these additional studies have tended to confirm the findings of the House Pension Task Force.

In all, there are 51 federal plans and approximately 6,630 state and local pension plans.[1] Since federal law (PL95-595) governs reporting and disclosure for federal plans, only the state and local plans would come under regulation if PEPPRA were enacted. Approximately 13 million current employees and retirees are covered by these plans.[2]

Most of the 6,630 plans are relatively small: according to the House Pension Task Force report, approximately 75% of the plans cover fewer than 100 workers, while only 2% cover over 10,000 workers.[3] However, most employees are covered by large plans: nearly 70% of the employees are covered by the largest 100 plans.[4]

Administration of these plans is also fragmented. According to the Task Force report, 9.6% of the plans are administered by states, 59.5% by cities, 4.6% by counties, 22.6% by townships, and 3.8% by special governmental districts (such as transit authorities).[5]

The following table shows the percentage distribution of covered employees by employment category.

TABLE I
DISTRIBUTION OF RETIREMENT SYSTEM ACTIVE EMPLOYEES BY EMPLOYMENT CATEGORY

Category	Percentage of Employees
Federal	1
State	22.8
Local	26.7
Police and Fire	6.7
Teachers	30.0
Teachers (higher education)	5.9
Other	9.7
Total	100.0

(Source: Table B6, Task Force Report, p. 58)

This table shows that teachers make up the largest single block of public employees covered by pension plans. While police and fire pension plans make up over 66% of all state and local pension plans,[6] they only represent 6.7% of all employees. Most police and fire pension plans are relatively small.

Administration of these pension plans is somewhat fragmented, even though over 40% of the plans have realized some economies through administration by multiple governmental bodies.[7]

Both the House Pension Task Force in 1978 and the President's Commission on Pension Policy in 1981 concluded that most governmental bodies have failed to develop comprehensive pension policies. This failure has led to a hodgepodge of programs that provide overly generous benefits to some and inadequate benefits to others. Inadequate funding policies have led some municipalities and states to either reduce pension benefits or seek new tax revenues for pensions already promised.

Since 1978, a number of states, as well as a number of state and local organizations, have created special commissions, task forces, and study groups to propose state and local pension reform. Some states have formed permanent retirement commissions to monitor the operations of pension systems. About 70% of the plans are administered by either an investment board or a retirement board. In general, these boards exercise full authority in investing plan assets.

Foremost among the national groups proposing pension reform have been the Municipal Finance Officers Association (MFOA), the National Governor's Association (NGA), and the National Conference of State Legislators (NCSL). While these groups have generally agreed with the need for reform, they have suggested that federal regulation is not the solution. Instead, they have conducted studies leading to "guidelines" for state and local governments to follow on a voluntary basis.

Some states have attempted to move from the "guideline" stage to implementation, with mixed results. In a few states, like California, heated political battles over reform legislation have produced mixed results. In that state, improvements in fiduciary standards have been signed into law. However, recently, the state's governor vetoed an important piece of legislation designed to take the portfolio management of the state's pension assets out of the political arena and to require full reporting and disclosure. The case of California demonstrates the difficulty of state and local pension reform at the local level.

Most state and local pension plans provide salary and service-related benefits of the defined benefit type. While most of these plans meet ERISA's age, vesting and service requirements, police and fire pension plans tend to have more restrictive vesting schedules.

Approximately 70% of state and local employees covered by pension plans are also covered by social security, as the following table shows. Police and fire employees and teachers are much less likely to be covered by social security than other employees.

TABLE 2

PERCENTAGE OF EMPLOYEES COVERED BY SOCIAL SECURITY

Category	Percentage
State	84.9
Local	75.9
Police and Fire	36.4
Teachers	56.5
Teachers (high education)	83.8
Other	86.6
Average	70.1

(Source: Task Force Report, Table B7, p. 59)

Pension Funds As Economic Institutions

In addition to providing benefits to employees, state and local pension plans are an important source of capital for the economy. Prudent management of these funds is important to both the beneficiaries of the pension trusts and the taxpayers supporting the plans. Table 3 shows how these plans' assets are predicted to grow in the future.

TABLE 3

PENSION PLAN ASSETS (ANNUAL INCREASE)

(Market value at year end in $ Billions)

Type	1983	1984	1985	1986	1987
Defined Benefit	761	838	951	1,036	1,185
Corp.	424	471	538	589	678
State & Local	260	283	318	344	387
Multi-Employer	65	71	79	86	98
Non Profit	13	14	16	18	21
Defined Contribution	228	265	314	348	406
Corporate	184	215	255	283	331
Nonprofit	44	50	59	665	75
DB & DC Total	989	1,103	1,265	1,384	1,591

Source: ICP, Inc.

Currently, state and local pension plan assets exceed $260 billion and are predicted to grow by approximately $30 billion annually over the next five years. The size of these pension funds ranges from very small plans with under $100,000 in assets to the largest system, California, covering thousands of employees with over $28 billion in assets.

While the growth of these funds may be a measure of increased retirement income security for participants and beneficiaries, it also suggests a danger: the very size of these funds makes them easy targets for diversion to purposes other than providing a proper rate of return to finance benefits.

Inadequacy of State And Local Regulation

Between 1979 and 1981, the President's Commission on Pension Policy reviewed the findings of the House Pension Task Force Report, initiated and coordinated new research on state and local pension plans, and held hearings around the country on problems with these plans. The final report of the President's Commission agreed with the House Pension Task Force that problems exist in the following areas: participation, vesting, reporting, disclosure, funding standards, fiduciary responsibility, limits on benefits or contributions, survivor benefits, and plan termination insurance.

Ironically, inadequate reporting and disclosure have hampered the development of conclusive research in some of these areas. However, enough is now known about some problem areas to suggest the need for immediate reform.

Inadequate Fiduciary Standards

Prior to the establishment of ERISA, private sector employees had to rely on state and local laws to protect them from abuse by plan administrators and trustees. Pension experts universally agree that the establishment of uniform fiduciary standards by ERISA has had a major influence on ending pension fund mismanagement. Both the President's Commission and the Pension Task Force concluded that public employees need this same protection.

The absence of uniform fiduciary standards has led to abuses such as conflicts of interest in management, and unprofessional investment practices. In the words of the Pension Task Force report: "There is virtual unanimity within the pension community that those who have control of pension assets should be held to high standards of behavior and should face liability upon failing to satisfy that standard . . . throughout the universe of state and local government retirement systems there is a virtual absence of clear guidelines in this vital area."[8]

A study conducted by Louis Kohlmeier for the Twentieth Century Fund documents widespread conflicts of interest in the management of state and local pension funds: "One of the most persistant conflict-of-interest situations in the management of public pension funds results from the policy, followed by many plans, of hiring local bankers, brokers and investment advisors and the practice of investing in local securities, even though better or lower cost services and higher yielding investments may well be available outside local boundaries."[9]

Some of this activity is well-intentioned: legislators and plan administrators sometimes seek to encourage local business. Often, state law will specify that certain types of investments, such as mortgages or municipal bonds, must make up a fixed portion of the pension portfolio. In addition, some state laws exclude investments in certain financial instruments such as corporate stocks.

Whether or not well-intentioned any sacrifice in investment return due to these restrictions may not be in the interest of either the beneficiaries of the pension plans or the taxpayers that support them.

Another area of fiduciary abuse highlighted by both the Pension Task Force Report and the Kohlmeier study concerns the absence in many states of professional investment management. Frequently, pension fund trustees are nonexpert in the field of portfolio management. This "often produces investment policies and practices that are significantly less valuable than that expected from professional investment advisors and managers, and generally found in private sector plans."[10]

In spite of the number of reports calling for changes in state and local fiduciary practices, local reform has been extremely slow, and the prospects for significant changes in the near future seem remote.

Even the experiences in states that have made moderate progress in pension reform illustrate the dangers of relying on that process for significant change. The battle for reform of California's fiduciary, investment management, and reporting and disclosure practices provides a current example.

For the past several years, the state legislature has been debating reform of the management practices of California's two large public employee pension funds, totaling over $28 billion in assets. A Joint Committee on Public Pension Fund Investments has, for the past two years, hired consultants, held hearings, conducted studies, sought the advice of experts throughout the country, and drafted legislation.

Consultant reports to the Committee found that the funds were difficult to oversee due to inadequate reporting and disclosure, that fund administration was not insulated from the political process, that portfolio performance suffered from the quality and quantity of resources devoted to investment staff, and that guidelines for trustee behavior did not exist.[11] The major consultant to the Committee, Dr. Marcy Avrin, reported that the taxpayers of California could save hundreds of millions of dollars per year by increasing the return of the pension portfolio to reasonable levels.[12]

The bills that were presented to the state legislature by the Joint Committee in 1982 and 1983 have been nearly universally praised by pension and investment experts.[13] At first it seemed successful passage of these bills was ensured. In 1982 an important breakthrough was made with the enactment of an ERISA-like prudence standard. However, when the legislature attempted to add teeth to this provision, with passage of a bill adding a comprehensive reporting and disclosure provision and separating the investment board from executive branch and legislative influence, the governor vetoed the bill.[14] Even if the legislature eventually prevails, this veto illustrates the difficulty of significant pension reform on the state and local level. It is unlikely that most states and municipalities will devote the time and resources for reform that California has.

By their very size relative to the budgets of their governmental sponsors, public pension funds are easy targets for budgetary and political manipulation.[15] Politicians are unlikely to relinquish their control over these funds voluntarily. Furthermore, full disclosure may lead to embarrassing reports of underperformance by political appointees. As long as the disclosure of this performance can be hidden or delayed, those responsible will not be held accountable.

Inadequate Reporting And Disclosure

Virtually every major study of state and local reporting practices has found serious inadequacies. Frequently, important financial, actuarial, and accounting calculations are either not performed or not revealed. In many instances, plan participants are not even informed of their basic plan benefits and legal rights through simple summary plan descriptions.

Most experts agree that complete reporting and disclosure of financial and benefit information is the least intrusive way to reduce abuse by pension trustees and plan administrators. Due to the highly complex nature of pensions, inadequate disclosure makes it impossible for even experts to detect abuse or mismanagement until it is too late: when pension promises are broken or additional taxes must be raised to prevent insolvency.

This point was emphasized by Louis Kohlmeier in his study of asset management practices: "Most public pension plans make financial reports of some kind to the legislature, to the governor or mayor, to employees and/or the general public. The great majority of such disclosures are wholly inadequate to allow legislators, employees or the public to judge the inadequacy of fund administration. . . . Rarely do reports disclose [investment information capable of being analyzed].[16]

In 1978, the House Pension Task Force concurred when it concluded that the "potential for abuse is great due to the lack of independent and external reviews of the operations of many plans."[17]

Late in 1978, the newly established President's Commission on Pension Policy began to coordinate an interagency research effort on state and local pension plans that resulted in three major reports in 1980 and 1981. Each of these reports confirmed this conclusion by the House Pension Task Force.

The first report, conducted by the Urban Institute, examined a sample of 100 large pension plans. While these plans are generally considered to have the best reporting and disclosure of all state and local plans, Table 4 shows that even they have serious gaps in disclosure.

TABLE 4
Frequency of Disclosure of Particular Items in Annual Reports

Item	Percentage of Plans Including
Auditor's opinion	40
Report of assets, liabilities, etc.	99
Statement of changes in reserves	54
Statement of factors (e.g., litigation and trends) that may affect financing and operation	35
Statement of investment policies and restrictions	47
Portfolio by asset type	93
Funding policy for employers and members	58
Date of last actuarial report	65
Changes in actuarial assumptions	23
Summary of actuarial assumptions	37
Amount of liability (actuarial balance sheet)	71
Number of former employees vested but not yet getting benefits	43
Number of beneficiaries	86

Source: Technical Appendix, *Coming of Age: Toward A National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 608.

Annual reports should contain complete accounting, actuarial, and financial information. However, the federally sponsored Urban Institute study showed a number of deficiences. Only 40% contained an auditor's opinion, and only 33% contained a statement of factors that might affect financing and operation. While 99% contained a statement of assets and liabilities and 71% contained an actuarial balance sheet, only 37% disclosed actuarial assumptions used to perform the calculations, and only 23% disclosed changes in actuarial assumptions that might affect year-to-year variations in the reported numbers. Without these further disclosures, the other figures are virtually meaningless even to experts.

Disclosure of adequate investment criteria and performance was also found lacking: only 47% disclosed even a statement of investment policies and restrictions.

The second product of the federal pension research effort was a report issued in 1981 by SRI International on small- and medium-sized state and local pension plans. Table 5 shows a summary of SRI's reporting and disclosure findings.

TABLE 5

Availability of Information on Plans

Type of Document	Document Exists (%)	Document Available to Employees (%)	Document Available to the Public (%)
Descriptive booklet for participants	58.0	49.5	40.7
Law, ordinances or code	71.3	66.7	63.3
Recent annual report	92.0	84.7	77.3
Recent actuarial report	88.0	77.3	70.0
IRS 5500G form	92.7	83.3	76.0

Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 609.

According to the report, fewer than half the employees have a booklet describing the benefits and eligibility criteria for their plans. Other documents such as annual reports, actuarial reports, and ordinances governing the plans are too often available to neither the employees *nor the public.*

The third report of the federal research effort was a report on financial reporting and disclosure prepared by the Municipal Finance Officers Association. They concluded that "available information indicates such reporting is today inadequate and confused and clearly in need of repair. Several factors contribute to the lack of good disclosure about [state and local] pension systems. . . ."[18] Further, the MFOA concluded that these deficiencies were due to a "lack of general authoritative standards for system disclosure and of enforcement of such standards that do exist."[19]

Inadequate Funding Standards

The reporting and disclosure evidence that is available indicates that a potentially serious problem exists with regard to inadequate funding of state and local pension plans. Whether the failure to disclose funding policies means that none exist or that the plans may fall into insolvency is difficult to discern.

Part of the federal research effort referred to earlier involved an attempt to estimate the funding status of state and local pension plans. The findings of this effort show a mixed picture:

(1) Large plans, in the aggregate, appear reasonably well funded;

(2) Some large plans face funding problems;

(3) Small plans cannot be easily evaluated due to inadequate reporting and disclosure;

(4) Small plans appear very vulnerable since many are dependent on outside sources of funds for their annual contributions.

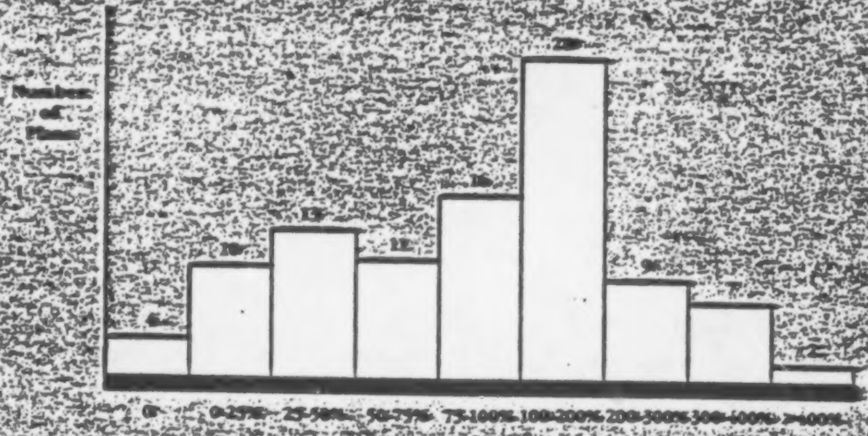
The research project attempted to evaluate large pension funds by simulating their plans' experiences using actuarial cost models developed by Howard Winklevoss Associates. The models showed that the large funds studied seemed to be funding according to reasonable schedules if they were viewed as a whole. However, when viewed separately, some plans, particularly police and fire plans, appeared to face potential problems in the future.

Table 6 shows one way of assessing the funding status of these large pension plans. The current and estimated funding status is measured by dividing the unfunded liability of each plan by the total payroll cost for the current year (1980) and the final forecast year (2024). The table shows that under current funding strategies, only 52% of the plans would be fully funded by 2024 even if no improvements are made in benefit formulas and no ad hoc benefit increases are made for the entire period.

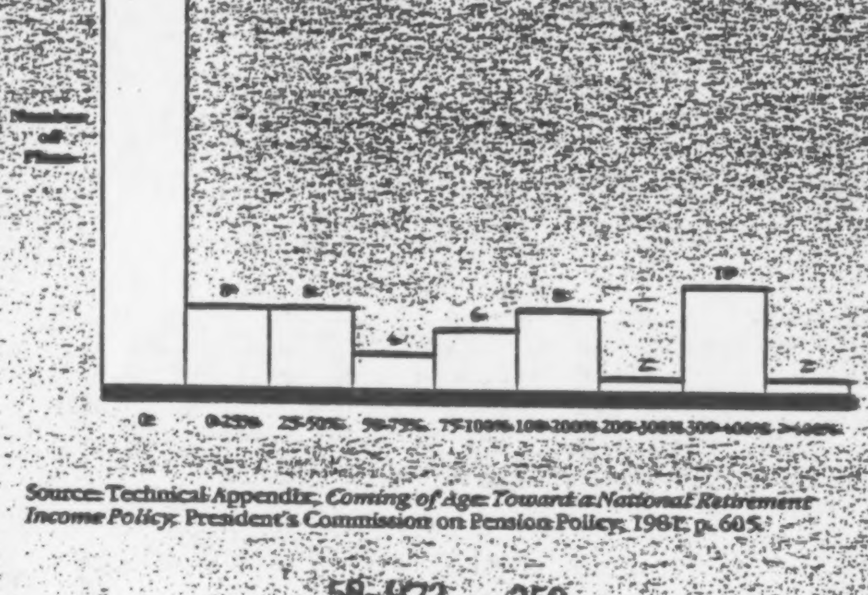
TABLE 6
DISTRIBUTION OF UNFUNDED LIABILITY AS PERCENTAGE OF PAYROLL FOR PLANS IN THE 100 PLAN SAMPLE

(Assets accumulated under current funding methodology forecast)

Initial Year



Final Year



Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 605.

Table 7 shows a potential problem for small state and local pension plans: their dependence on other sources for their annual pension contribution. According to this table very small municipal plans are particularly vulnerable. In an era when state and federal aid is being severely curtailed, this table provides reason for concern.

TABLE 7

PERCENTAGE OF TOTAL CONTRIBUTION BY SOURCE

	Number of Participants						
	1-4	5-24	25-99	100-199	200-499	500-999	TOTAL
Mandatory employee contributions	19.9%	18.5%	19.6%	19.6%	24.3%	27.8%	21.0%
Voluntary employee contribution	0.0	0.0	1.6	0.0	0.0	0.0	0.5
Employer contributions	27.1	47.7	58.1	76.5	62.8	72.2	60.3
Other contributions	53.0	33.8	20.7	3.9	12.9	0.0	18.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Technical Appendix, *Coming of Age: Toward a National Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 606.

While the federal research projects do not provide conclusive proof of a national underfunding problem for state and local pension plans, they do offer evidence of pension plan vulnerability to changes in benefit policies, interest earnings, contribution sources, state and federal budgets, and many other factors that are likely to affect them. Better reporting and disclosure would permit future research efforts to determine whether the funding problems faced by some pension plans are sufficiently widespread to warrant federal standards.

Footnotes

1. Technical Appendix, *Coming of Age: Toward a Retirement Income Policy*, President's Commission on Pension Policy, 1981, p. 587. See also, *Pension Task Force Report on Public Employee Retirement Systems*, House Committee on Education and Labor, as Cong. 2 sess. (GPO, March 15, 1978), p. 51.
2. *Task Force Report*, op. cit., p. 51.
3. Ibid., p. 53.
4. Data supplied by Howard Winklevoss & Associates to President's Commission on Pension Policy. See also, Preston, C. Bassett, "State and Local Pension Plans," in Technical Appendix, *Coming of Age: Toward a Retirement Income Policy*, President's Commission on Pension Policy, 1981, pp. 590-610.
5. *Task Force Report*, Table B5, pp. 56-57.
6. Ibid., p. 57.
7. Ibid., p. 62.
8. Ibid., p. 188.
9. Louis M. Kohlmeier, *Conflicts of Interest: State and Local Pension Fund Asset Management* (Twentieth Century Fund, 1976), pp. 9-10.
10. *Task Force Report*, p. 190.
11. See, Marcy Avrin, "Pension Fund Investment Decisions: Structural Reform," June 23, 1982; "Pension Fund Budget Decisions: Procedural Reform," September 13, 1982; "Investment Performance," November 30, 1982; all reports to the Joint Committee on Pension Fund Investment, Avrin Economics, Inc., 1982.
12. Avrin, "Pension Fund Investment Decisions," op. cit., p. 1.
13. See letter of Dan D. Lanoff to Louis Paper, Chairman, Joint Committee on Public Pension Fund Investments, June 17, 1983.
14. See letter of Governor Deukmejian to Louis Paper, July 28, 1983.
15. See statement of Francis R. Spaniola before the United States Senate Subcommittee on Savings, Pensions, and Investment Policy hearings on S. 2106, March 29, 1982, Washington, D.C.
16. Kohlmeier, op. cit., pp. 9-10.
17. *Task Force Report*, op. cit., p. 3.
18. John Peterson, "Public Pension System Financial Disclosure," Municipal Finance Officers Association, May, 1980, p. 3.

19. Ibid., p. 3.
20. See *Coming of Age: Toward a National Retirement Income Policy*, final report of the President's Commission on Pension Policy, February, 1981, p. 46.
21. Roy Schotland, Statement before the U.S. Senate Subcommittee on Savings, Pensions, and Investment Policy, hearings on S. 2106, March 29, 1982, Washington, D.C.
22. Schotland, op. cit., p. 9.

About the Author

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For the past two years, Dr. Woodruff has been an Associate Professor at the School of Industrial and Labor Relations, Cornell University. Currently, he is a consultant to a number of labor unions on collective bargaining and pension matters.

Senator HEINZ. Well, first of all, you have all given us some very excellent testimony, and I want to thank all of you for generally saying on balance kind things about the legislation.

I want to ask Ms. Moss. You pointed out that you had some problems. You would like to see the bill go further in limiting integration. You like SEP's. You want multi-employer plans covered.

Let me also thank you for your organization's help last summer at our hearings on "The Pension Gamble," which really helped to illustrate the problems we addressed in the legislation. It is out of that hearing that many of our provisions come.

And I do want to ask you—in your testimony you said we go part way toward solving these problems, the problems of the worker who was integrated out, the problem of the worker who was seated practically next door to and being paid approximately the same as a covered worker but was not covered because she was an hourly worker.

What steps do you feel Congress can take to complete the job while meeting the responsibility to reduce the federal budget deficit or producing revenue-neutral tax reform. What should we do that we do not do in this bill?

Ms. Ferguson.

Ms. FERGUSON. I think, although, of course, it makes us very unpopular in this room as well as with our friends, we do very much support the Treasury's proposal to repeal 401(k) plans. That certainly would do a little bit towards helping reduce the deficit. Our reasons are stated forth in our prepared statement.

It isn't that we oppose voluntary savings. On the contrary, we think it is tremendously important, for those who can afford to, to save for themselves.

Our concern is that these plans, as presently structured and even as limited, locked in for retirement, under your bill, are, in fact, encroaching on conventional pension plans. Every employer, every consultant we have talked to has admitted that, in fact, dollars that otherwise would have gone into improving a conventional pension plan are now going into a 401(k). 401(k)'s are the best tax shelter ever for middle income individuals, for second earners, and for people who have met their financial responsibilities, older workers, but, of course, for them it is too little too late.

Senator HEINZ. So your position would be women remain underpaid in the workforce. They often find themselves in jobs where there is not a defined benefit or defined contribution plan. The existence of 401(k)'s mitigate against the establishment of such plans and that hurts workers. You are here to represent presumably lower paid workers, workers that do not have pensions.

Your point, I understand. What other items would you attend to?

Ms. FERGUSON. We heard a very intriguing suggestion from an earlier panel, which I have to confess that I haven't really thought about in a tax context, the concept of offsetting IRAs for those who already have vested pensions. As you are well aware, the IRA for everybody concept came in in 1981 largely due to the pressure of engineers who change jobs so often that they never made the 10-year vesting requirement.

Under your legislation, reducing vesting to 5 years makes it much more likely that everybody will get some sort of pension if they are covered by a plan. In that context, same kind of offset for IRA's might make good sense. All of the statistics show that the individuals who are setting up IRA's are those who tend to have vested pensions, often very good pensions, and one only need look at the civil service system to see it particularly clearly.

Senator HEINZ. What about vesting, integration? Where do come out on that?

Ms. FERGUSON. Well, as Ms. Moss mentioned, we fully support the 5-year vesting. We, of course, would like——

Senator HEINZ. Would you go further?

Ms. FERGUSON. Eventually. I mean, again, there is a cost involved here. We do not think the cost of reducing from 10 to 5 is very much. Reducing further, let us say to 3, could be put into the legislation on a long-transition basis, and I think should be seriously considered. We genuinely believe that your legislation will be the last pension legislation for a long time if it is as comprehensive as I think you would like it to be.

And, therefore, long-range thinking in terms of future generations is very important at this time.

Senator HEINZ. What about integration? You indicated that you questioned, Ms. Moss, whether there should be any integration permitted at all. Are you for just abolishing integration?

Ms. FERGUSON. Senator, if I can respond.

Senator HEINZ. Ms. Ferguson.

Ms. FERGUSON. To be quite frank, the Pension Rights Center position has been for some time the elimination of integration. And that was based on our conversations with workers and retirees who were terribly disappointed, outraged by what happened to them under integrated plans.

We have, as you may know, published a booklet, which I would like to make part of the record, "The Case of the Disappearing Pension," which sets forth the pension issue on both sides of it.

[The booklet from Ms. Ferguson is in the official committee files.]

Ms. FERGUSON. In recent months, we have begun talking with pension consultants and others in the industry. And we have said to them we will go back to square one; we will rethink the issues; we will examine the concepts underlying integration and see if we were wrong; see if there is any basis for it.

In our prepared statement we have basically concluded at this moment—and it could change, we are open to discussion on this issue—that the basic concepts that have justified integration are no longer tenable. You mentioned one of them in your Floor statement, the notion that Social Security is weighted in favor of lower-paid people; therefore, it is all right to remedy that tilt. This concept fails to take into account that high-paid individuals have savings, very, very substantial savings. And if your concern is benefit receipt, a total system, I think you have to recognize that savings of higher income individuals more than offsets the tilt in Social Security in favor of lower-income individuals.

The bottom line seems to be at this moment, from our conversations that we have had to date—they are really at just the beginning stages—that the real interest in integration, the real push for it is simply that many plan consultants feel that they cannot sell pension plans, that employers will not set them up, unless they can be tilted in favor of the higher paid. If that is the reason, then I think we should do it more directly. Rather than taking away from employees, let us give to employers in a more direct way. Now there are tax revenue problems with that, but I think that may be the direction.

Senator HEINZ. What would you give?

Ms. FERGUSON. Well, in your 415 limits proposals, although in the short range they cut a little bit, particularly for defined contribution plans, in the long-range if I read them correctly, you permit employers with both a defined contribution and a defined benefit plan to add the limits. That is very, very attractive to employers. Whether that makes sense in terms of the budget deficit is another question.

Senator HEINZ. Well, what you are saying is that you would——

Ms. FERGUSON. Explore the possibility. Simply, that is where we are.

Senator HEINZ. I am trying to translate what you said into kind of a policy choice for companies. Are you saying, well, if you are going to have these nice, to some I suppose, fairly high 415 limits, you have got to eliminate integration. Is that what you are saying?

Ms. FERGUSON. That conceivably is a possible tradeoff. Conceivably, one could say you could have 401(k) plans only for your high paid employees. I don't support that either.

But I think that rather than staying with even simplified integration rules, we may want to explore the real problem here, which is how much of a carrot do we have to give to employers to encourage them to do the right thing by the rank and file.

Senator HEINZ. Well, you are raising the issue of what does the country get for a tax expenditure of $45 billion, and is that tax expenditure, which we occasionally worry about as a revenue source, justified by what we are producing in the way of public policy results? That is the fundamental question you are raising. It is a question that we do raise at the outset in this legislation.

Let me ask Dr. Gray. Dr. Gray, you mentioned the simplified employee pension proposal. And in contrast, I guess, with Ms. Moss, you argue for an expansion of the enhanced SEP proposal that we have in our bill beyond the small employer context. Our intention in limiting it to employers of 25 or fewer workers was to target new and marginally profitable small businesses which have high concentrations of presently uncovered workers. Can you suggest an alternative way of targeting presently uncovered workers other than the 25-employee limit?

Dr. GRAY. Well, I do not think it is necessary to put a limit on in order to target them. I think it is admirable to target those people because part of the reason that so few women are covered aside from the vesting and the integration, is the fact that they do work for very small employers who are marginal in many ways. So I see nothing wrong with trying to encourage those sorts of people.

On the other hand, arbitrary cutoffs, of course, are always difficult because I run into that with my own students who say I don't understand why 70 is passing; why couldn't it be 69. Well, the same thing is true is what if we had 26 employees and we then have to 40 times as much paperwork.

Senator HEINZ. I admit it is arbitrary. There is plenty of precedent for Congress being arbitrary.

Dr. GRAY. Indeed.

Senator HEINZ. Do you have a better alternative?

Dr. GRAY. I don't see why if the purpose is targeting it is necessary to put the limit in.

Senator HEINZ. How would you target?

Dr. GRAY. I think the plan can be made available to any employer. I think that through public education sorts of things, both on the part of employer organizations and employee organizations, you can make clear to the small employers that this option which does not require nearly as much paperwork is available to them. And I think it will be automatically more attractive. But I do not think that has to be done necessarily by cutting it off to a given employee limit. So I would like to see an education campaign targeting the small employee and employer and particularly targeting those people who are not covering their low-paid employees and part-time employees, what have you.

Senator HEINZ. For them you would say to educate them, set up one of these; do not set up a qualified pension plan or some other alternative?

Dr. GRAY. I would say that given your resources and given the amount of expertise that you have available to you this is probably your only option, only realistic option.

Senator HEINZ. In your testimony you also state that S. 1784 will fall short of remedying the problem of the disappearing pension. I am not sure I fully understand that. We provide that the accrual of a lower-paid employee cannot be less than one-half the accrual of a higher paid employee. Or in the case of an offset plan, no less than one-half the benefit to which the employee would have been entitled absent integration. That means, and our intent is, that the employee must receive something from the plan. Some employees, as we well know from our hearings this summer, do not receive anything from the plans.

Is not that a minimum pension benefit?

Dr. GRAY. It's certainly a great deal of progress, and it does cover a lot of people whose pensions would otherwise have disappeared. You still have people whose pensions disappear because they have not met the vesting requirements, for example.

I think it was Mr. Erlenborn who pointed out that there is a certain amount of Russian roulette. He did not describe it as Russian roulette; he described it as actuarial considerations, but they are really not different.

And the reason why you did not want to vest quickly is because that way you could make a lot of people pay in and not very many people get the benefits. Well, that is a disappearing pension. And it disappears for women more than it disappears for men, although a lot of men are hurt by it as well.

So I think the integration provisions are substantial improvements. The vesting provisions are a substantial improvement. You could still have other things like more provisions for portability, as well as vesting, more coverage of part-time workers, that kind of thing.

So it is certainly a significant step, but there is more that could be done.

Senator **Heinz**. All right.

Dr. Hoffman, first of all, I want to say I really appreciate your enthusiasm for the goals of our bill. It is a product of a lot of hard work. And there is a fellow sitting just to your right who has put in a lot of those hours in the person of Alan Reuther. And, Alan, we are grateful to you as well as Dr. Hoffman for your thoughts, for your hard work and for those ideas of yours that we accepted.

I am also intrigued about the idea of a national private pension portability program. And I take it you mean something more than the mandatory transfers of distributions to IRA's. Could you elaborate on that concept that the UAW posed to some employers in the aerospace industry and the role you see for the Federal Government.

Dr. **Hoffman**. Right. First of all, it is very complicated, and we recognize that up front. But we think we ought to start along the trail.

We think that you can make a very valid argument that anyone who works for an employer who has a Government contract then effectively works for the Government. And if you assume that to start with, you can assume [laughter] and underlying arrangement.

Senator **Heinz**. If you have got a hardware store and somebody from GSA comes in for some paperclips, they are ours. Is that right?

Dr. **Hoffman**. I will go along with that. [Laughter.]

In any case, however you get there, you can do it industry by industry—and some of the European countries have some fairly advanced arrangements on this. Germany, for example.

Let me start with the notion that we put together a while back, and it was the National Industrial Group Pension Plan, which covers a number of employers, several hundreds by now.

And this has the advantage of portability because you work within the industry. That is, with an employer covered by that pension plan. You can move to another employer covered by that pension plan.

If you carry that further and you go to the companies within the aerospace industry where we represent employees, a have presented to them notions of how you would carry with you pension credits rather than the assets. The assets either would be distributed between plans, which is complicated, or pension credits would go with the employee from one employer to another.

You would have to work out areas of eligibility, and benefit amounts. But it has the advantage of also carrying with it nonincome retirement benefits; namely, health insurance, and also life insurance to a lesser extent.

Senator **Heinz**. You are right, it is complicated.

Dr. **Hoffman**. Yes. I think that is why we had to get started on it right away. I think it has much more of an opportunity to provide for security in retirement than the opportunity to just carry assets or rollover to an IRA. It is the kind of pension that we prefer because of the security arrangements and we think we ought to start studying it.

Senator HEINZ. We have got some problems getting unanimity on this legislation. I do not know that we are going to be able to introduce an additional element of complexity into what is already a fairly contentious subject.

I want you to know, Bill, you have been well represented every step of the way. [Laughter.]

Dr. HOFFMAN. I will take that into consideration.

Senator HEINZ. Mr. Welsh, I am sorry Senator Chafee is not here because he was the Senate sponsor of the legislation that you are very much in favor of. He championed that for you. And he is clearly an expert in the area. I do not pretend to be. He was the chairman of this subcommittee or at least an earlier version of it in the 98th Congress.

I do gather from your statement that you feel there are some parts of this bill, our bill, which will affect State and local government plans. As the legislation stands today, what specifically are those provisions that will affect you, and how will they affect you?

Mr. WELSH. Let me ask Mr. Loveless to respond.

Senator HEINZ. Mr. Loveless.

Mr. LOVELESS. Mr. Chairman, if I may answer that question. Most of the provisions of the legislation, as currently worded, do not apply to State and local government retirement systems because they amend sections of ERISA which are cross referenced with the Internal Revenue Code sections.

There are, however, pre-ERISA code requirements that do apply to public plans. Specifically, the 415 limits the integration requirements would apply to State and local plans. Our examination of the legislation, with the exception of those two areas, appears to indicate that no other provisions apply to public sector plans.

Senator HEINZ. Are there any provisions of the bill that, aside from those two, should be extended to state and local governments?

Mr. WELSH. Mr. Chairman, I think the problem we are dealing with, as we somewhat outlined in the testimony, is a much more profound and fundamental problem.

Senator HEINZ. I understand the much more profound question which is should the Federal Government regulate state and local pension plans and do a lot of other things.

Mr. WELSH. No.

Senator HEINZ. I misunderstand it.

Mr. WELSH. Let me see if—I think it is important——

Senator HEINZ. Maybe I do.

Mr. WELSH. I think it is important. We are really dealing with a situation in which there is an extraordinary unknown. When you ask us as to what should be applied and what is needed, we are in the dark in terms of a great many of the areas that present the most serious problems. We simply do not have the information in the most basic reporting and disclosure area, leaving aside the question, for example, of the degree to which the Federal Government should or should not set fiduciary standards.

We have a problem in knowing what goes on in your State, Pennsylvania. There are about 1,500 separate State and local pension plans.

Senator HEINZ. It could be worse. We have got far more local governments than that.

Mr. **Welsh**. But you have got 1,500 separate plans in the State of Pennsylvania, about a fifth of all the plans in the United States. And the problem is that you just simply do not know—many of those local plans are vastly underfunded. Nobody has accurate information.

And, therefore, when you begin to start dealing with the question of the role of the Federal Government or whether these things can be dealt with through modifications of local ordinances or State law, we need help from you and the Congress to simply get the facts together on a national basis.

Now let me take it one step further because I think it is important. About a third of the State and local government employees in this country are not covered by the Social Security system today. And while there is disagreement as to the degree as to how you proceed on that basis and the rate that you would do it and the impact that it has on local and State government budgets in a time of fiscal crisis; the facts are that you cannot even cope with that problem in a rational way because you do not have the kind of information you need to examine the question of impact of Social Security coverage. So I think that what we are saying is that we need this kind of help from the Congress so that we can begin to deal with some of the more complex issues that you are presented with and we are coping and dealing with in the private sector. Now it does not necessarily mean that the Federal Government has to regulate nor would we want the Federal Government to regulate all aspects of State and local plans.

Senator **Heinz**. Bill, that is an amazing statistic of the number of plans that exist in Pennsylvania as a proportion of all the plans in the United States. It sounds to me as if there was information on just the Pennsylvania plans you would have solved nearly a quarter of your information deficit problems. There are two ways to achieve that.

One is to get 98 other Senators to agree to write a bill to subject Pennsylvania to the tender inquiries of the Federal Government. And the other is to get Pennsylvania to do it.

How are you doing it up in Harrisburg?

Mr. **Welsh**. As a matter of fact, the State legislature last year began to move in that direction, Senator. We supported legislation that began to tackle this.

The proportion, however, of plans is not necessarily the same proportion of the employees we are dealing with. In other words, you have got many plans in Pennsylvania that are one-employee plans.

So I mean we are not dealing with it in terms of just solving Pennsylvania problems. We have got problems in Texas; we have got problems all over the country.

This proposal is a bipartisan proposal. Congressman Erlenborn who testified earlier was a very strong advocate of this proposal when he was in the House, and we have had a wide range of support from virtually all the organizations in the public sector, NEA, other labor organizations, AARP etc. There is a very broad basic belief that this would be helpful in dealing with the public sector pension problem across the country. It is not necessarily as controversial as it may appear.

Senator **Heinz**. Well, I find your comments most interesting. I hope we will have the opportunity to spend some time on that.

At this point, as I mentioned to Dr. Hoffman who has some interesting ideas on pension portability credits, I am somewhat nervous if we have any possibility of making some significant pension reforms and improving our approach to retirement income policy this year; particularly, as I think once we do tax reform it is going to be enormously time consuming both for this committee and the Floor of the Senate.

I have some reluctance to complicate what is already a fairly difficult exercise, as you might gather from some of the witnesses who do not always reflect total unanimity.

Mr. **Welsh**. We are pretty good lobbyists.

Senator **Heinz**. Either among themselves or worse with me.

Mr. **Welsh**. You many find that we, in fact, enhance the possibility of the legislation being enacted.

Senator **Heinz**. This is possible.

Mr. **Welsh**. Because, in fact, we are pretty good lobbyists in terms of the organizations that are represented.

Senator **Heinz**. This is possible.

Mr. **Welsh**. And there is a lot out there that could be helpful to you.

Senator **Heinz**. And we would be pleased to consult with you and others on this particular issue, particularly on the need for information and so forth.

Are there any other comments that any of you would care to make?

Ms. **Ferguson**. May I just make one very quickly just to reiterate Dr. Gray's point about simplified employee pensions. There has not been too much discussion of them. But when you talked about the universe of small employers, SEP's are an extraordinarily easy and administratively cost-free way of taking care of employees.

We had hoped this morning to have for you a booklet which is due back from the printer. It is called the "Pension Plan Almost Nobody Knows About." We think that once employers and their employees learn about SEP's, that they will take off in that very small company universe that right now has such poor plan coverage.

Senator **Heinz**. That would be good news indeed.

I want to thank all of you for your help. You have been an outstanding group of witnesses today, all of you. Thank you very much for your time, your effort, your thoughts, your creativity, your hard work.

[Whereupon, at 12:31 p.m., the hearing was concluded.]

[By direction of the chairman the following communications were made a part of the hearing record:]

Statement Of The
American Society Of Pension Actuaries

The American Society of Pension Actuaries (ASPA) is a national professional society whose 2,100 members provide actuarial, consulting and administrative services to approximately 30% of the qualified plans in the United States.

ASPA applauds the serious concern for the long term retirement needs of our country evidenced in the development of the Retirement Income Policy Act of 1985 (RIPA, S.1784). This is in sharp contrast to the recent activity of the House Ways and Means Committee in its adoption of the pension provisions of H.R. 3838, which were drafted in a frenetic atmosphere dominated by tax considerations. We urge the members of the Finance Committee to reject the pension provisions of H.R. 3838 and not to modify current pension law as part of the tax reform effort. An effective and growing private pension system is critical to the welfare of our aging population. The importance of this system should dictate that the laws governing its operation be constructed as a separate effort based on a sound national retirement income policy and with the participation of both the tax and labor committees. We believe that the development of S.1784 will follow this path.

We are exceptionally pleased that S.1784 has recognized that the recent proliferation of pension legislation has placed a severe strain on the private pension system and consequently has set forth at Section 151 delayed effective dates. These generally are the later of --

(1) 2 years after the date of the enactment of RIPA, or

(2) the earlier of --

  (A) the effective date of the first plan amendment adopted after the date of the enactment of RIPA, or

  (B) December 31, 1990.

However, we believe the practicalities of the situation indicate the need for modification of these provisions. It must be recognized that amendments will be required to the vast majority of plans in the next couple of years to conform to as yet unpublished final regulations under REA, TEFRA, and DEFRA. As a practical matter, therefore, the provision that would govern the effective date in most cases would be the 2 year post enactment delay. While this is helpful, and certainly a step in the right direction, we suggest that a better solution would be to adopt the concept that we have previously suggested to the Congress of quinquennial implementation. Under this concept legislation affecting employee benefit plans enacted within a five year period would become effective after the end of that five year period. We have suggested 1990 as the first implementation year in the quinquennial cycle. The effective date provisions of RIPA would reflect this approach, which we feel would restore much needed stability to the private pension system, if Section 151(a)(2)(A) were deleted so that the effective date generally would be the later of 2 years after enactment of RIPA or December 31, 1990.

It needs to be recognized by the Committee, and by all members of the Government, that the process of amending a plan is not merely the preparation of the legal document. Whenever the amendment affects any aspect of plan design (eligibility, vesting, benefits, etc.), a lengthy process of study and examination precedes the legal drafting to arrive at a set of new plan provisions best designed to suit the particular situation of the plan sponsor. Therefore, amendments to conform to the Bill would not merely involve the drafting of amendments. In fact, the legal drafting is only a small fraction of the total process.

The comments which follow are divided into four principal categories.

A. Proposals which we support;

B. Proposals which we oppose;

C. Proposals with respect to which we favor our previously submitted suggestions;

D. Added proposals which we believe should in incorporated.

In each of these categories, we have included comments and suggestions for improvement, even with respect to many of the proposals with which we are in fundamental agreement.

As a prelude to our general commentary, let us point out that we are intrigued by the concept of dividing the universe of pension and profit sharing plans into the two categories of "Retirement Plans" and "Non-Retirement Plans" (savings or capital accumulation vehicles). We believe that this creates the opportunity for structuring the rules for Retirement Plans within the context of a national retirement income policy and a series of goals for post-employment income. At the same time, it permits non-retirement plans to be separately and adequately evaluated on their own merits, without their impact on such sensitive issues as tax expenditures being used to shape the more fundamental national social policy.

While we applaud this division of plans (Retirement vs. Non-Retirement), we continue to totally oppose the other and completely artificial division of plans which is perpetuated by the proposed legislation. We refer, of course, to the separate rules which apply in many instances, and, in fact, will be extended in others, to plans of large employers and small businesses. We totally oppose any discrimination which exists or is perpetuated against plans of smaller employers, and consequently, are genuinely disturbed that the proposed legislation not only continues the existence of the top-heavy plan concept, but actually widens the gap between such plans and their large employer counterpart. As we have pointed out on a number of occasions in the past, it is the small plan area where coverage is more severely lacking, and in which the complexity of rules creates the greatest disincentive. Therefore, we urge that the proposals be immediately amended to contain the total repeal of Section 416 of the Internal Revenue Code.

As a starting point for this commentary, we have assumed that an overall tax plan, with rates essentially similar to that in the Administration's proposal, will be enacted within the relatively near future, but that it will be absent any pension contents which are more properly developed within legislation, such as the Retirement Income Policy Act, which is intended to formulate a comprehensive approach to our long term retirement needs.

A. PROPOSALS WHICH WE SUPPORT

1. The General Retirement Plan/Non-Retirement Plan Division.

2. The Special Requirements for Qualification as a Retirement Plan.

   These two concepts clearly are very closely related. As previously noted, the general division of plans into the two categories is one which we support. With one exception, we generally endorse the requirements for qualification as a retirement plan.

The one exception is the requirement for a mandatory commencement date for retirement income, on which we comment in more detail in paragraph C5 below.

3. Retirement Plan Coverage as a Prerequisite for Non-Retirement Plan Coverage.

4. Required Level of Adequacy of Retirement Plan.
These requirements appear to be an effective incentive for expanding employee coverage under genuine retirement programs. We support the concepts in general.

In particular, we believe that the adequacy levels set forth in sections 104 and 204 represent reasonable standards, and bear a sensible relationship between the defined benefit and defined contribution plans.

Qualifying wording should be added to the proposal indicating that the minimum accrued benefit/contribution requirements may be satisfied by inclusion in only one plan of the employer, where more than one plan in maintained covering the same employees. For example, an employer providing a defined benefit retirement plan satisfying the .5% per year benefit accrual return, and thus qualifying to maintain a non-retirement plan, should not have the 3% minimum contribution requirement if he wishes to add a defined contribution retirement plan.

With respect to the defined benefit accrual, added clarity is required in defining the years which serve as the multiple. There appears to be a conflict in definition between section 104 and 204.

5. Salary Reduction Arrangements May be Part of any Retirement Plan.

This is a highly beneficial concept since it creates a far greater degree of horizontal equity than presently exists under the 401(k) plan requirements. It enables employees entering into salary reduction arrangements to be protected against curtailment of contributions because of the uncontrollable event of absence of business profits. In addition, it promotes simplification of administration by permitting a firm desiring to provide both the security of a defined benefit plan and the opportunity for salary reduction arrangements to do so within a single vehicle.

6. Retention of Present 401(k) Discrimination Tests.

From the data which have been published in recent numerous surveys, it appears that the present tests are successful.

They appear to both promote a high level of participation in 401(k) plans throughout all wage ranges and a non-abusive pattern of contributions in the overwhelming majority of situations. They also have become widely understood. They should be retained.

7. Reduced Limitations on Salary Reduction Contributions.

8. Reduction in Applicable I.R.A. Contributions by Salary Reduction Amounts.

We support the concept of limiting salary reduction contributions to one-half of the usual defined contribution limitation, and permitting employer matching contributions to make up the difference. However, please also note the concerns we express about the overall 415 limitation revisions, in paragraph C2 below.

The reduction of applicable IRA deductions by salary reduction amounts is sound policy. It is also administratively possible, unlike proposals in which the reduction is to be attained in the reverse order.

9. Limitations on Non-Retirement Plans.

Limiting non-retirement plans to a contribution level, which is essentially half that permissible under defined contribution plans, is acceptable to us.

We do have a question with respect to the inter-relationship of these reduced limitations, with whatever portion of Section 415(e) is left intact. Will the overall defined contribution limit alone be affected by the combined plan tests, or is it intended that the special non-retirement plan limits also be reduced within the context of 415(e)? (For example, if a firm had a maximum defined benefit plan, would this mean that a non-retirement plan could not exceed 4% of compensation, or 6.25% of the Social Security wage based, by application of the 1.4/1.25% rules. If this effect is intended, it should not be.)

10. Increased IRA Early Withdrawal Penalty.

(No comments)

B. PROPOSALS WHICH WE OPPOSE

1. "Non-Repeal" of Top-Heavy Rules.

As previously noted, we totally oppose the perpetuation of discrimination against plans maintained by small business employers. Therefore, our most strenuous opposition is focused on the absence of repeal of the top heavy rules. This non-repeal appears to us to be particularly ludicrous since many of the provisions of RIPA come very close to providing requirements for all plans which are equivalent to those imposed by Section 416. Consider -

- The proposed vesting changes will actually result in full vesting one year sooner for top heavy participants who are covered by six-year graded rule.

- The amendments to Social Security integration effectively provide minimum benefits and contributions for all participants in a qualified plan.

- The integration proposals also contain a compensation limit for discrimination purposes which is essentially equivalent to the $200,000 top heavy maximum.

2. Repeal of Section 415(e), Except for Top Heavy Plans.
In the past, we have supported a combination of elimination of 415(e) for all plans with an excise tax on very high retirement benefits, such as that contained in the Administration's tax proposal which utilizes a $112,500 threshold (we have suggested that this threshold be higher; $150,000 was our proposal). Without such a combination, we question the repeal of Section 415(e) with respect to any plan, particularly in the environment of the current budget deficit.

We totally oppose the elimination of 415(e) for non-top heavy plans alone. The best argument for repealing this section is its complexity. Its application is far more burdensome, and frequently more complex, for a small plan than for a large plan. There is no conceivable justification for an individual's retirement income to be limited differently, depending upon the size of the business for which he works. This proposal should be rejected.

3. New Coverage Rules.

We are concerned that there has been no demonstrated need to change the coverage rules which have been in effect since well before the passage of ERISA. Therefore, even if there is a degree of merit in this proposal, the need for change should be demonstrated before any change is made. There is a degree of merit in the proposed modifications, and there is a degree of merit in the concept of providing a definitive "bright line" test which cannot be misinterpreted. However, there can be disadvantages to a bright line test simply because of the difficulty in devising one that provides sufficient flexibility.

Consider an employer, with 800 employees in the relevant work force and under the Social Security wage base, who maintains a plan with 100% coverage. If that firm should acquire another (which meets the relevant subdivision criteria), which has 199 employees and no plan, it can exclude all employees in the new subsidiary from coverage. However, were it to acquire a subsidiary with 201 employees, all would be required to fully participate in the employer's plan, potentially at great expense. (An analogous scenario would exist where the acquiring company has a richer plan than the subsidiary, even if the latter's program is entirely adequate.)

As a practical matter, were the employer to acquire the 201 employee subsidiary, he would most likely discharge two of the employees, rather than be forced to provide full coverage. The law should not create the need for an action of this nature.

We are somewhat confused by the inclusion of the rules in a new Section 409(B) of the Internal Revenue Code, rather than as an amendment to Section 410(b). Does this mean that the existing 70% test, and classification test, will remain in the law? This does not appear to make sense.

We urge that the Committee utilize the coverage data that is available (from 5500 forms) to ascertain whether a need for correcting the participation standards exists, and to pinpoint areas of abuse. We suspect that it will find that lack of coverage in the private sector is not as a result of inadequate participation standards, but rather primarily stems from the need for plan adoption to be more widespread.

4. Changes to Simplified Employee Pensions.

Our opposition to these changes relates not so much to their substance, but to the apparent lack of coherent relationship between SEPs and the newly-conceived Retirement USA approach. This may be due to confusion on our part, but it is difficult for us to understand the reason for, or distinction between, the establishment of these separate vehicles. We do not question simplicity as an appropriate objective. However, we become concerned when an employer may have to devote more time to determining which simplified program is appropriate for him than he would in installing and administering his most complex possible choice.

We suggest that the best features of both SEPs and Retirement USAs be combined, and that a single, unified approach be followed. We will be happy to work with the Committee in formulating that approach.

C. PROPOSALS WITH RESPECT TO WHICH WE FAVOR OUR PRIOR SUGGESTIONS

1. Revision of Integration Rules.

The American Society of Pension Actuaries has expended considerable resources in developing a series of revisions to integration. These were presented to the House Subcommittee on Labor Management Relations, together with our April 3, 1985 testimony.

We believe that these proposals represent the best approach to integration reform that has yet been devised. We feel they are particularly superior because of their orientation toward retirement income goals, as part of a national retirement income policy. We are somewhat upset that the drafters of the current proposals seem to have chosen to sidestep the issue of retirement income goals, which we believe is crucial to any coherent policy.

We, therefore, urge that the Committee re-examine these proposals which have been unanimously endorsed by our Board of Directors and are widely supported by our membership.

The topic of integration is not only controversial, but also highly complex. Because of its orientation toward results, we believe it is most effectively debated in the context of specific examples.

Toward this end, ASPA would be happy to work with the Committee in developing a series of models showing the comparative results of the various integration proposals which have been advanced, including our own, the RIPA method, the VIP minimum benefit approach, together with the existing rules. In this way, we believe it can most clearly be seen which approach most consistently provides fairness, benefit adequacy, and goal orientation.

We are confident that our previous proposals will measure up under these tests.

2. Modifications to Section 415 Limitations.

We were pleased that the Bill took a step in the direction of creating a more rational relationship between the limitations on defined benefit and defined contribution plans. We also believe that relating the dollar limitations to the Social Security wage base is a sensible and understandable approach. However, we are concerned that the Bill also takes a step backward in that it imposes a new set of reductions to the 415 limits, especially with respect to defined contribution plans.

In a legislative outline in testimony submitted to the House Subcommittee on Labor Management Relations on April 3, 1985, we suggested retaining existing defined contribution limits, as well as the existing percentage limit for defined benefit plans. The revision which we proposed was to increase the defined benefit dollar limit to $120,000 to retain the four-to-one mathematical relationship, and to provide further incentive for defined benefit plan formation.

We do not support a reduction in these limits, particularly with respect to defined contribution plans. There has already been one very significant reduction in TEFRA, together with an effective reduction resulting from the cost-of-living freezes that have been imposed. Further reductions are not called for at this time.

It can be argued that the defined benefit reduction will be relatively small, if the probable Social Security wage base, at the time the Bill becomes effective, is compared to projected growth in the $90,000 limits. If this is the case, then at the very least, a plan should be able to maintain its existing limitations until such time as any new limits were to catch up.

Elsewhere, we have commented on our strenuous opposition to the repeal of Section 415(e) limits for non-top heavy plans.

3. Imposition of Mandatory 5-Year Vesting.

In the April 3, 1985 legislative outline, we suggested that a single vesting schedule should not be imposed upon all plans. Instead, we suggested that the ERISA concept of three alternate statutory vesting schedules be retained. We still believe this should be done in order to allow the employer a degree of flexibility of choice.

We were especially disturbed by the comment in the Summary of the Bill, which read "Of course, top heavy plans will still be required to meet the special vesting requirements in Section 416 of the Internal Revenue Code". The term "of course" suggests that there is no other alternative. There clearly is, and we again urge the repeal of the top heavy provisions.

4. Repeal of 10-Year Forward Averaging

In our April 3 legislative outline we endorsed the general concept of 10-Year averaging repeal. However, we did not advocate total and immediate repeal. Rather, we suggested that 10-year averaging should remain available for death payments, because of the financial hardship that accompanies the circumstances of such payment. We also urge that transitional allowances be included with any form of repeal or modification.

We also conditioned our support of eliminating 10-year forward averaging upon the passage of overall tax reform, which brought with it a reduction in marginal tax rates. Absent such reduction, we believe that repeal would result in too severe a penalty.

We remain supportive of the fundamental concept of encouraging retirement plans to provide benefits in the form of retirement income. However, we would like to caution the Committee that the existence of 10-year forward averaging is one of the incentives that frequently will motivate an employer to adopt a qualified plan, even if he does not specifically plan to take advantage of it. Therefore, the benefits of repeal should be weighed against the loss of this incentive. Perhaps a modification should be sought that would, at least, partially retain the incentive.

5. Distribution Rules for Retirement Plans.

We support the Bill's intention to create an environment wherein Retirement Plans would be primarily established to provide retirement income. We believe that a uniform set of distribution rules should be applicable to all retirement plans.

In our earlier legislative outline, we had expressed concern that prohibitions or excise taxes with respect to any distributions before age 59 1/2 were too arbitrary. We urged that an exception be made for genuine retirement income. We are pleased to see this contained in the Bill.

We remain concerned about establishing an age at which retirement benefits are required to commence, particularly if the statutory age occurs prior to actual retirement.

This is especially true to the extent that such a statutory age is imposed on a limited class of individuals, such as it is both in present law and in the Bill. It seems contradictory that the Government would simultaneously be prohibiting mandatory retirement policies in the private sector, and, at the same time, imposing mandatory receipt of pension benefits.

Under present law, a minimum annual distribution amount is calculable, essentially being that amount which will expend the retirement benefit value over the participants' and beneficiaries' joint life expectancy. We suggest that this minimum distribution amount should be "offset" by income earned by the participant from the plan sponsor, as a means of determining whether the participant were actually continuing to work, or was merely allowing his account value to accumulate.

To the extent that an excise tax above an annual income threshold is enacted, we suggest that this in itself will be an adequate deterrent against unwarranted extension of plan benefit distribution.

D. ADDED PROPOSALS WHICH WOULD BE INCLUDED

1. Small Plan Formation Incentives.

In our April 3rd testimony, we urged the adoption of a tax credit for new plan formation, to be applied with respect to small businesses. We were disappointed to find nothing of this nature in the Bill.

It has been clearly demonstrated that lack of retirement plan coverage most prominently exists within smaller businesses. Incentives of this nature, which we suggested (and which had previously been proposed by Senator Javits), are a part of the solution to this problem. Together with top heavy repeal, we are convinced that the trends of small plan termination and non-formation can be reversed.

It has been argued that a tax credit for plan formation will not be effective because most small businesses which do not have plans are not doing well enough to benefit from the credit. To the extent that this is the case, they certainly cannot afford plan contributions, absent the credit. On the other hand, the credit may well be the spur that induces many small businesses to act, where previously they have not.

If the credit is successful, our projections indicate limited cost to the Government, particularly compared to the social benefit derived. If it is not successful, the cost will be minimal. It should be tried.

2. Commentary on Asset Reversions

While numerous bills have been introduced into Congress addressing the issue of asset reversions, it does not appear that any of them have been within the context of overall pension reform. In addition to this, or perhaps because of this, we do not believe that these proposals have addressed the issue properly.

The American Society of Pension Actuaries has prepared an extensive position paper addressing the entire issue of asset reversions, which we are enclosing with these comments. We urge that the Committee study it carefully.

We also urge that it serve as a framework for adding this subject to the contents of The Retirement Income Policy Act.

3. Additional Plan Formation Incentives

In prior testimony we submitted to Congressional Committees, we included two suggestions which we believe would serve as incentives for new plan formation. We think that they should be addressed in The Retirement Income Policy Act.

The first of these is to totally repeal the 25% deduction limitation contained in IRC Section 404(a)(7). Such repeal would be a particular incentive for small plan formation, since it is very difficult for many small businesses to establish retirement programs sufficiently early in their existence to permit adequate benefits to be provided within this restriction. The various limitations contained in Section 415 provide adequate control with respect to total contributions to a firm's retirement program. This artificial limitation on the incidence of those contributions should be eliminated.

A second suggestion is to restore the estate tax exclusion for qualified plan death benefits that existed in IRC Section 2039(c) prior to the enactment of TEFRA. It was our experience that the existence of this exclusion provided a major incentive for new plan formation, again principally within the small business community. Additionally, it was an incentive that resulted in especially low cost to the Treasury, since in practice only a small percentage of the actual death benefit distributions ever took advantage of it. Consequently, we urge that this exclusion be restored.

STATEMENT OF
THE AMERICAN COUNCIL OF LIFE INSURANCE

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

The following statement is submitted on behalf of the American Council of Life Insurance ("ACLI"). The ACLI is a trade association with a membership of 629 life insurance companies. In the aggregate these companies account for approximately 95 percent of the life insurance in force in the United States and hold 96 percent of the assets of insured pension plans.

The legislation that is the subject of these hearings -- S. 1784, the Retirement Income Policy Act of 1985 ("RIPA") -- represents a thoughtful attempt to grapple with several important issues confronting our nation's retirement system. The ACLI fully supports the basic premise of RIPA -- i.e., that the current voluntary system of employer-sponsored retirement plans should be retained, and that the growth and development of such plans should be encouraged. Moreover, the ACLI concurs with RIPA's preamble where it notes that:

1) Current incentives for pension plan formation are inadequate;
2) The rules governing employee pension benefit plans lack consistency and coordination;
3) Continuous, costly legislative changes have discouraged the growth and development of employee pension benefit plans; and

4) The lack of an articulated national retirement income policy has encouraged frequent and piecemeal legislative changes.

The life insurance industry would welcome an end to the flood of revenue-driven, legislative tinkering in the pension area. Constant changes in the laws governing qualified retirement plans discourage employers from implementing new plans or enriching existing ones. This is particularly true with regard to small employers where, historically, pension coverage has been the weakest. If new pension rules are to be adopted in this session of Congress, they should be carefully considered, thoroughly debated and offer a constructive, long-range, and stable retirement policy.

In this regard, many aspects of RIPA represent just such an attempt. RIPA addresses retirement issues in a considered fashion with policy -- rather than revenue -- the guiding concern. By contrast, we find the pension provisions of another major piece of proposed legislation -- H.R. 3838, the Tax Reform Act of 1985 -- far less satisfactory in that they focus almost exclusively on revenue concerns. Moreover, in our view, the revenue-driven press of tax reform provides a wholly inappropriate forum for discussion of long-range issues affecting the retirement security of millions of American workers.

We therefore appreciate this opportunity to participate in a more deliberate consideration of retirement issues, and look forward to working with the Subcommittee in fashioning a retirement "income" policy as opposed to a retirement "revenue" policy for this country.

Our specific comments on RIPA's provisions follow.

RETIREMENT VERSUS NON-RETIREMENT PLANS

The cornerstone of our private retirement system is its flexibility. Employers today are able to choose from a wide range of retirement savings vehicles in designing a program responsive to their particular financial situation, unique workforce and relevant competitive norms. While specific aspects of the system may need improvement, a major restructuring of a program that has produced impressive -- and increasing -- advances in the degree of retirement security anticipated by millions of workers is not, in our view, necessary.

RIPA's central feature, however -- the distinction it draws between "retirement plans" and so-called "non-retirement savings plans" -- represents just such a restructuring. We believe the result of RIPA's retirement/non retirement plan dichotomy will be to seriously undermine the flexibility that is the greatest strength of the private sector retirement systems. This would occur because RIPA's prohibition on withdrawals of "retirement plan" funds prior to age 59 1/2 would severely diminish the attractiveness of participating in such plans by the young and lower-paid.

RIPA attaches two important attributes to retirement plan status: 1) unless the employer maintains a retirement plan offering minimum benefits, he is precluded from offering employees a "non-retirement savings plan"; and 2) retirement plans have contribution limits that are at least twice as generous as those of non-retirement plans. With some important exceptions, most traditional defined benefit plans would meet the RIPA "retirement plan" definition. Most existing defined contribution plans and profit-sharing plans, however, would be characterized by RIPA as non-retirement savings plans. Due to the large number of stand-alone defined contribution and profit-sharing plans that now exist, this feature of RIPA will prove to be extremely disruptive.

The ACLI agrees with the RIPA premise that funds which receive favorable tax treatment because they are set aside to provide retirement benefits should, in fact, be used primarily for that purpose. But, while we agree that the focus of pension plans should be retirement income adequacy, financial security at other points in life cannot be entirely separated from retirement income security. We thus believe there is an important role to be played in national retirement policy by plans that provide for retirement while still permitting withdrawals for limited purposes.

We disagree, however, with both the RIPA requirement that unless an employer maintains a "retirement plan" he cannot offer a plan that allows for withdrawals under limited circumstances, and RIPA's characterization -- and inferior treatment -- of such arrangements as "non-retirement" plans. The underlying premise of RIPA seems to be that these plans are second-best, "stepchildren" in the overall benefit plan scheme -- a conclusion at odds with both the great public popularity of these arrangements, and their success in encouraging employees to save for their own retirement.

RIPA would apply severe withdrawal rules to "retirement" plans, presumably on the theory that such restrictions will ultimately enhance retirement savings. We disagree. Saving for retirement is a long term proposition. Thus, to assure meaningful levels of post-retirement income, policy should focus on encouraging employees to begin a habit of saving as early as possible. Those who most need such encouragement are lower paid and younger workers, who are least likely to focus on the need to set aside funds for retirement, and have the least amount of discretionary dollars to commit to this end. These employees are generally unwilling to make a long-range commitment to retirement saving unless they are assured of some recourse to their accumulated funds should legitimate need (e.g., financial hardship or serious illness) arise. This is especially true for plans involving employee contributions.

Recognizing this need for some limited degree of fund access, profit sharing and thrift plans have traditionally provided for pre-retirement employee withdrawals. Under RIPA, however, if an employer wished to continue to offer a plan that currently allows withdrawals, he or she would be forced to: 1) either redesign the old plan to conform it to retirement plan status; or 2) establish a new, primary "retirement-type" pension plan to supplement the existing arrangement. Neither of these alternatives is realistic for many employers.

Most smaller employers would be unable to afford a second pension plan requiring minimum benefits for the very financial reasons that initially led to the choice not to establish such a plan. Similarly, conversion of the old plan to "retirement plan" status would probably not be feasible, as many employees will not wish to participate in a plan which -- as would be the case under RIPA -- provides no mechanism for direct withdrawals from the plan prior to age 59 1/2. Without sufficient employee participation, these plans would be unable to meet ERISA coverage and/or nondiscrimination requirements and thus would be disqualified. Thus, for many employees the end result of RIPA's withdrawal prohibitions will probably be termination -- without replacement -- of an existing retirement plan.

If the ultimate purpose of these withdrawal rules is to discourage plans which are employee contributory on the theory that employers should fund their employees' entire retirement benefit, we disagree with the approach taken in RIPA to achieve this goal. In essence, RIPA uses a "stick" rather than "carrot" technique -- by severely diminishing the attractiveness of so-called "non-retirement" plans (via much lower contribution limits) and mandating that these plans be supplementary to a retirement plan. We strongly doubt that such an approach will be successful. Far more preferable and effective, in our view, would be provisions couched in terms of positive incentives -- rather than negative, penalty-type disincentives -- to induce employers to establish or enrich retirement plans.

Finally, it is unclear under the RIPA rules exactly what constitutes a "non-retirement savings plan". The special limitation set out in RIPA Section 214 for non-retirement savings plans is expressed in terms of contribution limits. However, it appears that many defined benefit plans could fail to meet one or another aspect of the RIPA retirement plan definition, and thus would also be characterized as non-retirement plans. A defined benefit plan would, for example, presumably, fall within RIPA's non-retirement plan category if it provided for a pre-age 59½ early retirement lump sum benefit.

NEW SECTION 415 LIMITS

Section 214 of RIPA would change the maximum contributions and benefits allowable under Internal Revenue Code Section 415. Under the RIPA rules, the defined benefit plan limit for a participant would be reduced to 200% of the Social Security taxable wage base or $84,000 for 1986 (versus $90,000 under current law), and the defined contribution limit would be lowered to the lesser of 50% of the Social Security wage base ($21,000 for 1986) or 20% of compensation (versus the $30,000/25% of compensation rule under current law). For non-retirement plans, the RIPA limit would be the lesser of 10% of compensation or 25% of the Social Security wage base ($10,500 for 1986).

We think it is very important that the 415 limits be indexed to the cost of living. Moreover, we find the approach taken in RIPA of tying the Section 415 limits to the Social Security wage base to be quite sensible. By using this technique, the cost of living adjustment that is built into the Social Security wage base is automatically applied to qualified plan benefit limits as well. We are opposed, however, to any lowering of contribution and benefit limitations from current law levels. The current Section 415 limits were significantly reduced in 1982; we cannot see how further reductions in these limits will advance RIPA's stated goal of enhancing retirement security. Moreover, under RIPA, the relationship between the defined benefit/defined contribution limits would shift from the 3-to-1 level under current law to a 4-to-1 ratio. We are not sure what the rationale is for either this ratio or the drastic cutbacks in the Section 415 defined contribution limits. We believe both defined contribution and defined benefit plans play an important role in the repertoire of retirement savings vehicles, and should be treated in an equitable fashion under the tax laws.

Without question, however, the most adverse Section 415 cutbacks would be those applied by RIPA to non-retirement savings plans. As discussed previously, we do not believe RIPA's attempt at categorizing -- and prioritizing -- various modes of retirement savings is appropriate. Moreover, since it would appear that many existing plans -- including defined benefit plans -- would now fall within RIPA's non-retirement plan category, the new lower limit would create major disruptions for many existing retirement arrangements.

TREATMENT OF SECTION 401(k) PLANS

The ACLI finds RIPA's treatment of Section 401(k) plans far more appropriate than the approach of the House passed tax reform bill. We thus fully agree with RIPA's retention of the existing Section 401(k) non-discrimination (ADP) test. The ADP test has proved to be a very effective means of encouraging employees at all income levels to save for retirement. Moreover, we believe the current law rules strike an appropriate balance in this area, providing benefits to the higher paid under the same limitations as are generally applicable to qualified defined contribution plans, but requiring meaningful participation by the lower paid group as a condition to qualifying for these benefits.

RIPA's approach to Section 401(k) plans, however, is dramatically undercut by RIPA Section 211. Under this provision, a plan may include a CODA only if the plan is a "retirement plan" as defined in RIPA Sections 101 and 102. (Under current law, a CODA must be part of a profit sharing or stock bonus plan.) By forcing Section 401(k) arrangements to conform to the definition of "retirement plan", these arrangements would be subject to RIPA's prohibition on pre-age 59½ cash withdrawals. We believe such limitations will severely cripple the functioning of many Section 401(k) plans.

A Section 401(k) plan can only work if a meaningful relationship exists between deferrals elected by the higher paid and lower paid groups. However, where plans involve elective employee contributions, adequate participation generally cannot be assured unless the plan provides some means for limited pre-retirement withdrawals in the case of hardship. This is especially true for lower paid employees, who would be unwilling -- and, indeed, imprudent -- to commit scarce discretionary dollars without some recourse in case of emergency or financial hardship.

Because participation by the lower paid is essential to the operation of a Section 401(k) plan, precluding all pre-retirement cash withdrawals from Section 401(k) plans will, in our view, ultimately result in the termination -- without replacement -- of many CODA's. This would be an unfortunate result, as Section 401(k) plans have been an extremely successful device for expanding retirement coverage for American workers. Two recent surveys report that, where Section 401(k) plans are available, more than 60% of eligible employees were actually participating in such plans at the end of 1984. Further, Census Bureau data indicates that low-income workers were three times more likely and middle-income workers twice as likely to participate in 401(k) plans than in IRA's. As many as 10-15 million workers are now participating in 401(k) plans. In addition, a recent survey conducted by one of our member companies indicates that almost 43% of the Section 401(k) plans were new plans. The survey also shows that the trend is toward increased small plan utilization of Section 401(k) arrangements.

There is one other aspect of RIPA's treatment of Section 401(k) plans that we find troublesome -- that is, RIPA Section 214, which limits employer CODA contributions from salary deferrals to 25% ($10,500) of the Social Security wage base. Presumably, the 25% figure was chosen to permit dollar for dollar matching by the employer without exceeding RIPA's defined contribution plan limit (i.e., 50% of the Social Security wage base). However, this rule would penalize participants in plans where there is no employer matching or where the match is at less than a dollar for dollar rate. We do not believe additional, special CODA contribution limits are needed. The actual deferral percentage test of Section 401(k) -- in conjunction with the current law defined contribution plan coverage, participation and benefit limitation rules -- adequately insure that benefits under Section 401(k) plans are not excessive and are equitably distributed.

TREATMENT OF DISTRIBUTIONS

One of RIPA's most dramatic changes is the prohibition it would place on pre-age 59½ cash withdrawals from retirement plans. Without repeating our previous comments on this point, we wish to stress that at the very least this requirement needs to be changed to take account of the very common situation of early retirement. It is typical for many employers to offer early retirement at age 55. Participants in defined contribution plans often take their account balance in a lump sum form. We think it would be entirely consistent with RIPA's overall thrust to permit lump sum or installment withdrawals in this situation. The harsh alternative that RIPA currently provides -- non-retirement status for the entire plan -- hardly seems justified in this context.

In addition, we oppose RIPA's proposed elimination of ten-year averaging and capital gains treatment for lump sum distributions from all types of plans. Presumably, the purpose of this proposal is to encourage lifetime payments of retirement income. This approach ignores the fact that for a variety of legitimate reasons (e.g., health, immediate financial need, the desire to start a new venture during retirement years), a life annuity may not be the best retirement choice for a given individual. The result of such an approach would be to dilute the flexibility that is one of the major strengths of America's private retirement system.

Similarly, we oppose RIPA's proposed increase (from 10% to 20%) in the penalty tax on early IRA distributions. Even if it is appropriate to recoup the tax deferral benefit on an early distribution, the purpose and design of any penalty must be carefully considered. A flat penalty, for example, does not give any effect to the length of deferral or the value of the deferral to the individual and is regressive in its impact. Moreover, at a 20% rate, the new IRA penalty in most cases clearly goes beyond recouping any deferral benefit and can only be viewed as punitive.

NEW COVERAGE RULES

RIPA would replace the current law coverage requirements with a complicated series of mechanical percentage tests. Under these tests, the percentage of employees who must be covered varies depending on whether: 1) the employer's work force consists of two or more "allowable subdivisions"; 2) the plan is contributory; or 3) the plan provides "substantial benefits" to participants. Most significantly, RIPA would eliminate the traditional "non-discriminatory reasonable classification" (fair cross-section) test.

The new RIPA coverage rules may not accomplish the goal of increasing coverage under private retirement plans. It is generally agreed that the real problem of coverage today lies in creating plans where they do not now currently exist -- particularly for employees of smaller firms. Fine-tuning and further complicating required coverage percentage figures may (or may not) increase coverage under established plans. It does nothing, however, toward expanding the number of employers offering the opportunity to participate in a retirement program to their employees. Indeed, if anything the new rules will create confusion and frustration as employers try to design retirement programs best suited to the particular mix and needs of their employees.

VESTING

Section 121 of RIPA would require a retirement plan to provide 100% vesting for a participant who has completed 5 years of service. In view of the substantial mobility of labor in this country, reasonable vesting is essential in order to prevent undue loss of pension benefits and to help provide adequate pensions for retired employees. While every effort should be made to improve the vesting of pensions by voluntary means, we are not convinced that mandating more rapid vesting than is now required by ERISA would be the best solution to this problem . We are, however, currently reviewing this issue and hope to have suggestions for improvement.

INTEGRATION

We agree that the current law integration rules are overly complex and confusing. By contrast, the proposed RIPA integration rules are generally straightforward and relatively simple to apply. While we have not yet had the opportunity to fully assess the effect of the RIPA proposed changes, in general, we think two concerns must be balanced in devising an appropriate level of integration.

First, consistent with the current law's nondiscrimination concepts, integration formulas should assure that combined Social Security benefits and private pension benefits are at least as high a percentage of pre-retirement gross earnings for low income individuals as for high income individuals. At the same time, however, we do not think it is appropriate to require qualified plans to provide many covered employees in the lower paid segments of the work force with private pension benefits large enough to bring their combined pension and Social Security benefits above their pre-retirement gross earnings.

In this regard, there is one aspect of the proposal that we find troubling. Under RIPA Section 215(c)(3)(C)(ii), greater required integration ratios (to be prescribed by IRS regulation) may be triggered by various circumstances -- including the presence in a plan of "any actuarial adjustment factor". We would appreciate the opportunity to work with your staff to see if there is a simplified approach that could be taken in this area.

MANDATORY MINIMUM BENEFITS

Section 104 of RIPA requires an employer to maintain a retirement plan providing minimum benefits as a prerequisite to maintaining a non-retirement savings plan. In evaluating the need for minimum pension benefits, an issue that must be considered is whether any mandatory income to provide additional retirement income is desirable once Social Security has provided a floor of retirement income protection. Moreover, the question of whether the specific firms involved can afford the supplementary retirement income protection must be answered. We would be glad to work with you and your staff to assess the impact of this proposal.

EFFECTIVE DATE

We appreciate RIPA's recognition of the long lead time necessary to effectuate pension plan changes. Employers need relief from the annual legislative changes that have become commonplace. As currently structured, RIPA appears to provide several effective date options; i.e., the later of:

1) two years after enactment; or
2) the earlier of: the effective date of the first plan amendment after enactment; or 12/31/1990.

In reality, however, most plans will have to be amended to comply with TEFRA, DEFRA and REA and therefore would have only two years within which to comply with RIPA. We assume that the inclusion of the 1990 effective date indicates an appreciation of the magnitude of the changes proposed in RIPA. The fact that plans have to be amended for some other purpose should not preclude them from making use of the 1990 effective date.

CONCLUSION

Thank you for giving us this opportunity to testify on this important piece of retirement income legislation. We look forward to participating with the Subcommittee and staff in the continuing discussion of an appropriate retirement income policy for this country and in the development of guidelines that will implement such a policy.

Respectfully submitted,
AMERICAN COUNCIL OF LIFE INSURANCE

STATEMENT ON THE RETIREMENT INCOME POLICY ACT OF 1985
FROM THE AMERICAN ACADEMY OF ACTUARIES
TO THE SENATE FINANCE SUBCOMMITTEE ON
SAVINGS, PENSIONS AND INVESTMENT POLICY

February 11, 1986

The American Academy of Actuaries appreciates the opportunity to provide comments to the subcommittee on this very important piece of legislation.

Background

The Academy is a professional association of over 8,000 actuaries involved in all areas of specialization within the actuarial profession. Included within our members are approximately 85% of the enrolled actuaries certified under the Employee Retirement Income Security Act of 1974 (ERISA), as well as comparable percentages of actuaries providing actuarial services for other employee benefit plans such as life, health and disability plans. As a national organization of actuaries, the Academy is unique in that it includes actuaries with expertise in all areas of actuarial specialization.

With respect to government relations, the Academy views its role as a provider of information and actuarial analysis in order that policy decisions may be made with informed judgment. It is our belief that the training and experience of Academy members allows for a unique understanding of current practices in employee benefits. It is our intention to communicate that understanding in ways that assist public policymakers.

National Retirement Income Policy

The Academy is very encouraged to see a clearer delineation of a national retirement income policy in Section 2 of the Retirement Income Policy Act (RIPA). As the Academy has said in previous statements, we believe that our nation needs a retirement income policy which continues to encourage the existence of a vital, dynamic private pension system. Contemplated changes in tax policy should be measured against this policy to reduce the risk of adoption of legislation which produces short term enhancement of tax recipts if the legislation also has long term detremental effects on benefit security.

The Academy supports fully each of the ten elements identified in RIPA as forming our national retirement income policy. We have publicly advocated many of these ideas in our written and oral testimony before Congress. We urge that each of the changes contemplated by RIPA be examined against this policy.

Retirement Income Policy Act of 1985

1. Since 1980, there have been five major pieces of legislation which affect retirement plans. These are the Deficit Reducation Act, the Economic Recovery Tax Act, the Multiemployer Pension Plan Amendment Act, the Retirement Equity Act and the Tax Equity and Fiscal Responsibility Act. The delayed effective date of RIPA will help plan administrators. This will allow time for existing plans to achieve some measure of stability, since many of the recent legislative changes have yet to make their full impact felt. We believe that it would be preferable if a moratorium were placed on the introduction of any future legislation affecting retirement plans for a period of at least two years. During that time, thorough studies could be undertaken

of the entire pension area. We would be happy to assist the Congress and their staffs in conducting these studies and measuring the results against the national retirement income policy set by RIPA. The results would enable legislation to be drafted when its impact was understood. As a alternative to a legislative moratorium, we would suggest that future pension legislation not carry an effective date that is sooner than the effective date of the provisions of RIPA.

2. We are aware of many pension plans that permit distributions earlier than age fifty-nine and one-half either in income or lump sum form. We recognize that such provisions might lead to some abuse and to the endangering of retirment income security. However, the availability of benefits earlier than age fifty-nine and one-half and in lump sum form can be a substantial benefit to pensioners. We would suggest that the existing rules on benefit distributions be retained for "retirement plans." IRC Section 411(d)(6) prohibits the removal of the lump sum cash option or the availability of benefits before age fifty-nine and one-half for benefits accrued to date. If the restrictive benefit distribution rules of RIPA are to be imposed, then some grandfathering should be allowed for benefits accrued to the effective date of RIPA.

3. The current coverage requirements for qualified pension plans are complex. However, the proposed changes under RIPA may not represent an overall improvement. In particular, current tax law permits the exclusion from defined benefit plans of employees who are hired within five years of normal retirement age. The actual cost of providing defined benefit pensions increases as the age of hire increases. The current provision protects plan sponsors from the heavy financial burden that would be imposed if employees hired within five years of normal retirement date had to be included in defined benefit pension plans. This

protects the hiring of older employees and thus promotes the spirit of ADEA. We believe that this provision should not be changed without evidence that it would help coverage and employment of older Americans. If the current rule is retained, we also recommend that employees hired within five years of normal retirement date be allowed to participate in a "non-retirement plan" even if they are excluded from a "retirement plan." We also anticipate that there will be practical problems with "allowable subdivisions" that may be in totally different lines of business and, therefore, require different plan types and contribution levels to be competitive.

While the proposed coverage provisions are more mechanical than those under current law, they appear to permit discrimination against employees earning more than the Social Security wage base. We do not understand why such discrimination would be beneficial, since those employees have the same need for benefit coverage and retirement income security as employees who happen to earn below the Social Security wage base.

4. One of the key provisions of RIPA is the requirement for "substantial" retirement plan coverage before a non-retirement plan can be adopted. It appears that the adequacy of the plan is measured in terms of career average pay (although the requirement for defined benefit plans needs to be clarified). Many current retirement plans do not express benefits as a function of either career pay or average final pay. Calculations will need to be made to determine whether these plans meet the definition of "substantial." We believe it would be a good idea to investigate further the impact of these requirements before they are adopted.

The combination of Social Security and a "substantial" retirement plan produces disproportionately high benefits for lower paid employees (combined income is about 80% of final salary). Perhaps a lower contribution or accrual requirement (such as .4% times years of service for defined benefit plans and 2% of pay for defined contribution plans) and/or a limit on the number of years of service (such as 25) would be appropriate.

We are also concerned that neither measure of adequacy explicitly reflects the impact of inflation between the date of termination of service and the time period over which benefits are paid. A benefit which appears adequate at retirement, may be depleted through the impact of inflation, even if the inflation proofing of Social Security continues and does provide a cushion. The impact of inflation on the adequacy of retirement income is as significant as other matters addressed in RIPA. It has a direct bearing on several of these. A through investigation of this issue prior to enactment of any adequace/coverage-related pension legislation would be helpful. This might begin with an examination of recent experience in other countries, notably in the United Kingdom.

5. The current vesting standards reflect a philosophy that retirement benefits are a reward for long service. The reduction under RIPA to five years for retirement plans would appear to represent a fundamental change in that philosophy to one of granting a benefit to virtually every employee. We are unable to comment on whether the existing or proposed philosophy should be incorporated in legislation. We suggest, however, that if the current ten-year standard is to be tightened, then a nonarbitrary period should be chosen. Whether that period is five years, or as short as one year or as long as eight or nine years, its choice should be made after a clear understanding of the impact of such a change. There is no fundamental reason why

the vesting standards should be more stringent for non-retirement plans than for retirement plans. Both have the same need for benefit security. While it is clear that employees covered by pension plans will be able to change jobs more frequently with less detriment to their pension benefits, the administrative cost may rise substantially and employers may refrain from starting pension plans if the vesting provisions appear to the burdensome. The goal should be to add to the delivery of meaningful benefits to employees without incurring more administrative cost.

6. Tying the Section 415 maximum limits on pension benefits and contributions to the Social Security wage and tax base has a good deal of merit, provided that the taxable wage base is not substantially restructured. This would provide for a reasonable increase in these limits as inflation erodes the value of the Section 415 dollar limits. This will ultimately add to the retirement income security of many participants because of the funding requirements of qualified plans. Because of the present static (or even reducing) Section 415 limits, excess benefits will be provided in unfunded, non-qualified plans to a growing proportion of higher paid employees. This is not to the advantage of plan participants and runs counter to many of the elements of the national retirement income policy specified in RIPA.

7. Section 131 contains requirements for integration with OASDI. Some additional changes in this area may be needed.

    a. It may be appropriate to expand the bill's defined contribution provisions to put a maximum on the spread between the above-and-below contribution percentage. We suggest that the spread be set at the then current OASDI contribution rate for each future year.

b. The bill should clarify how retirement and non-retirement plans in combination should be integrated. If the retirement plan meets the substantial coverage and integration rules, can the non-retirement plan also be integrated? If so, how?

c. The rules for offset integration appear to favor lower paid employees, since Social Security is tilted in their favor. Limiting the offset to a maximum of 50% of the accrued benefit (without the offset) can end up providing over-adequate benefits to lower paid employees in order to provide adequate benefits for higher-paid. The alternative of allowing a maximum offset of 50% of the Social Security benefit may be more appropriate. This treats all salary levels more equitably.

8. RIPA also proposes several changes in the way the maximum on benefits and contributions (Section 415 limits) is determined. Since these limits do not have actuarial implications, per se, the Academy has no particular position on the changes. However, we would make a couple of observations on the proposed rules:

a. A grandfather clause will be needed to handle benefits accrued under defined benefit plans which exceed any new, lower Section 415 limits.

b. Reducing the Section 415 limits even further runs counter to many of the elements of the national retirement income policy expressed in Section 2 of RIPA. Reducing these limits does affect rank and file employees as well as higher paid employees, since owners will not provide a greater benefit (as a percentage of compensation) for the rank and file than for the higher paid. This forces many of these benefits outside a qualified plan into unfunded, deferred compensation plans. Not only are these benefits less secure, they are also often provided in a more discriminatory way. For example, a nonqualified plan may be used to make the benefits of top management whole in relation to their pay and service, while other higher paid employees who are not part of top management, may have no nonqualified plan and receive a benefit equal to the dollar limit for qualified plans.

c. Eliminating the Section 415(e) combined plan limit for all plans except for top-heavy plans again seems to run counter to the national retirement income policy. Most of these top-heavy plans cover smaller employers whose employees have the same need for benefit adequacy as the employees of larger employers.

Conclusion

The Academy would like to thank the subcommittee for the opportunity to provide written testimony on RIPA. We would also like to thank the staff for the opportunity to work with them through the development stages of this bill.

We recognize that Congress has several other major complex pieces of proposed legislation to consider and that these may have detremental effects on RIPA through incorporating pension-related sections and through reducing the time available for consideration of RIPA. We urge that Section 2 of RIPA be passed into law at the earliest possible date, even if no other provisions of RIPA are enacted in the near future.

American Academy of Actuaries
Pension Committee
Norm S. Losk, Chairperson

Subcommittee on Single Employer Plans
Larry D Zimpleman
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Dennis J. Graf
Jan R. Harrington
Jeffrey F. Hartmann
Albert L. Hess
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David L. Lively
John B. Thompson

STATEMENT OF

The American Chiropractic Association
and
The International Chiropractors Association

to the

SUBCOMMITTEE ON SAVINGS, PENSION
AND INVESTMENT POLICY

SENATE COMMITTEE ON FINANCE

for hearings held

January 28, 1986

on S. 1784

The American Chiropractic Association and the International Chiropractors Association represent, together, approximately 23,000 doctors of chiropractic nationwide. We are grateful for this opportunity to call your attention to an important modification that needs to be made in the Employee Retirement Income Security Act of 1974 (ERISA) -- an amendment that will preserve the health care patient's freedom to choose the type of health care provider best suited to their personal needs. S. 1784, the Retirement Income Policy Act you are hearing today, would be an appropriate vehicle for an amendment such as we propose.

As major non-medical care providers, doctors of chiropractic have long been interested in efforts to improve competition in the health industry. The history of our profession's successful effort to establish itself in the face of organized medical opposition is a matter of common knowledge. We have, therefore, first-hand experience with many features of the health care system that tend to stifle competition between competing provider groups and which impede the development and delivery of innovative health care.

We believe that competition in health care delivery is the primary key to controlling costs, and therefore, we strongly support any effort to effectively increase or preserve competition among the varied sectors of the health care industry. We are confident that competition between health practitioners and health insurers will greatly benefit the health care consumer in terms of both the quality and cost of health services.

But, as the search goes on for creative ways to control the rising costs of health care benefits, provisions of ERISA as they pertain to employee welfare benefit plans are acting as disincentives to the competition and patient freedom of choice that many states have fostered over the years.

ERISA was enacted by Congress in 1974, primarily to protect the interests of employee pension plan participants. The law's mandate, however, also extended to employee welfare (health) benefit plans. Therefore, it has had, and continues to have, a significant impact on the delivery of health care services.

A provision in ERISA -- it's preemption clause -- was intended to facilitate the basic purpose of the Act by preempting certain state statutes that might interfere with the establishment of uniform employee protections in pension and benefit plans. Clearly, the setting of national pension standards and protections required a federal authority to override conflicting state laws.

But a problem has developed. The preemption clause, which allows state laws to be overriden, has had a negative effect on state insurance equality laws.

Insurance equality laws have been enacted into law in an overwhelming number of states. These statutes basically protect a health care consumer's right to select a licensed practitioner of his or her choice to render needed health care or, in other instances, actually mandate certain benefits to be offered by all insurance companies doing business in a state. They "equalize" the services available and the health care consumer's right to choose. The intended results are to place nonallopathic health care providers on the same footing with allopathic providers. These laws "level the playing field", if you will, by assuring that the health care consumer has access under health benefit plans to the widest range of licensed health care providers. State insurance equality laws are an important foundation in insuring competition in the health care delivery system.

Forty-two states currently have some form of insurance equality law. A list of those states is submitted with this statement for your immediate reference. These laws are consistent with the time-honored rights of the states to regulate insurance.

Since the enactment of ERISA, however, a variety of ERISA health benefit plans -- including self-insured plans -- have frustrated the purpose of these state insurance equality laws by limiting reimbursement for covered benefits to only doctors of medicine and osteopathy, and certain other select practitioners -- many times freezing out altogether chiropractors and all other licensed health care practitioners otherwise provided for under state law.

There are three particular provisions of ERISA which are at the center of this controversy:

(1) a broad preemption provision relating to all state laws that "may now apply or hereafter relate to any employee benefit plan" -- if taken literally, this means that ERISA supersedes any insurance law that in any way relates to an employee plan paid for by or through an employer;

(2) a so-called "insurance savings clause", which saves from federal preemption "any law of any state which regulates insurance"; but which is followed by

(3) a provision that no employee benefit plan "shall be deemed to be an insurance company or other issuer for purposes of any state purporting to regulate insurance companies or insurance contracts" -- employee benefit plans referred to by this provision include the

self-insured or self-funded plans.

This third provision is of greatest concern in light of its application to self-insured health benefit plans under ERISA and as a result of the U. S. Supreme Court's "mixed" decision in 1985 in the case of Metropolitan Life Insurance v Commonwealth of Massachusetts. The Court's decision itself is straightforward; the facts of the case are rather simple.

Insurance companies in Massachusetts were ignoring the state law that required them to include certain minimal mental health care benefits in insurance policies under an employee benefit plan. The insurance companies argued that ERISA preempted this mandated benefit law; the Commonwealth of Massachusetts argued that these laws were exempt from ERISA preemption since they regulate insurance companies.

In an 8 to 0 decision, the Court agreed with the Commonwealth of Massachusetts and ruled that state-mandated-benefit laws concern the "business of insurance" and therefore are exempt from preemption under the terms of ERISA. For those who believe in state insurance equality laws and in the health care consumer's freedom of choice, this was a victory -- if only partial. It was only a partial victory inasmuch as the Court went on to give tacit approval to the other ERISA preemptive provisions, including the provision that grants special status to self-insured employee benefit plans. Although employee-benefit-plan insurance policies were exempted from ERISA preemption and are still subject to regulation by the several states, self-insured plans are not subject to state regulation or to inclusion for coverage under state insurance equality laws.

A self-insured plan is not an insurance plan; it is a plan funded through an employer's own funds rather than insurance indemnification. Although insurance companies often administer these plans, they do not provide the policies of insurance for the plans themselves.

A growing segment of the group health benefit market today involves self-insured or self-funded trusts developed by employers to fund health care benefit plans for their employees. The International Foundation of Employee Benefit Plans reports that out of the total of employer-sponsored health plans, the percentage that are fully self-funded rose to 50.6% in 1983, from 30% just four years earlier. Since 1983, the growth has been just as great because of the savings incurred by employers as opposed to the more traditional use of insurance policies purchased from third-party carriers.

The Supreme Court's acquiescence in ERISA's preemption of state insurance equality laws as they pertain to self-insured plans invites and encourages employers to shift even more rapidly to self-insured plans, if for no other reason than to avoid the coverage of duly-enacted state insurance equality laws. It is important to remember as well that these employers, who now in even greater numbers will choose the self-insured option, are the same employers who are in the forefront in the development of health maintenance organizations (HMO's) and preferred provider organizations (PPO's) -- both of which are now free from the concerns of state insurance equality laws if they are a part of a self-insured employee benefit plan.

Please remember, too, that the intent of state insurance equality laws is to promote competition, and to insure that the health care consumer is not artificially limited in his or her choice of health care providers by the economic constraints of what will or will not be reimbursed under health benefit plans.

ERISA's preemption clause, therefore, keeps employees covered under self-insured plans from enjoying the same basic legal protection and benefit coverage that employees covered by group health insurance plans enjoy.

The federal preemption of state laws is of particular concern to both patients of and doctors of chiropractic in rural areas of the country where one or two very large employers may dominate a community. Should those employers choose self-insurance, and choose to eliminate coverage for chiropractic, the effects are widespread and significant throughout the community -- for both patient and doctor.

For the last two years, legislation has been introduced in Congress that would eliminate ERISA's preemption of state insurance equality laws and their regulation of insurance policies and self-insured health care benefit plans. The 1985 Supreme Court decision alleviated the need to address insurance policy regulation, but the self-insured portion as well as the non-mandatory state insurance equality requirements remain and grow as a problem to chiropractors and their patients.

This legislation, as embodied in H. R. 1375, seeks to amend the provisions of the Employee Retirement Income Security Act of 1984 so as to permit options in the provision of certain health benefits. It seeks to resolve the conflict between the very sensible freedom of choice provisions of state law and the logical preemption clause of ERISA that has come to unintentionally burden the health care consumer.

The provisions of H. R. 1375 do not seek in any way to undermine or impair the strengths or purposes of ERISA. The proposal merely eliminates an unnecessary interference with individual choice and the rights of the states.

We do not believe it was the intent of either the authors of the 1974 Act or the Congress in passing it to apply the preemption clause to restrict a person's ability to select the health practitioner of his or her choice. Yet this has been the result.

We urge you to take the necessary steps to correct this problem, and to use the Retirement Income Policy Act, S. 1784, as a vehicle to do so.

Thank you for this opportunity to make our views known.

State Insurance Equality Laws

The following 42 states make chiropractic benefits available to health insurance beneficiaries through their insurance equality laws:

Alabama
Arkansas
Arizona
California
Colorado
Connecticut
Delaware
Florida
Georgia
Illinois
Indiana
Kansas
Kentucky
Louisiana
Maine
Maryland
Massachusetts
Michigan
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February 1986

STATEMENT
# of the
AMERICAN ASSOCIATION OF RETIRED PERSONS

INTRODUCTION

The American Association of Retired Persons (AARP) is the nation's largest membership organization, representing the interests of over 22 million members age 50 and above. The Association appreciates this opportunity to express its views on S. 1784, the Retirement Income Policy Act of 1985 (RIPA).

The ultimate goal of changes in the income support structure serving retired Americans must be the establishment of a minimum standard of living for all older persons and a reasonable guarantee of adequacy, stability and security of retirement income so that individuals can plan for economic security in their later years. To be adequate, a retired person's income should be sufficient to prevent a significant decline in the living standard achieved earlier in life. Social Security is the basic foundation for retirement income planning. But to achieve the adequacy goal, Social Security will have to be supplemented by income from other sources, particularly private pensions, employment, savings and other income-producing assets. To the extent that income from all sources fails to provide an income above the poverty threshold, then the underlying public assistance programs should be made sufficient to guarantee at least an income above that threshhold.

PRIVATE PENSIONS

Social Security will continue to be the most important source of retirement income for many years to come. But the private sector must play a bigger role for more Americans if future retirees are to be assured an adequate measure of economic security.

The current private pension system must expand significantly if it is to meet the needs of millions of Americans who have spent all or most of their adult lives in the labor force. Despite the enormous tax subsidy that the system now enjoys (about $40 billion in 1985) it is not now reaching most retirees and, without major changes, will not be a significant source of income for more many future retirees.

The private pension system has grown dramatically over the past 35 years. But, comprehensive changes are needed in the existing private pension system if it is to better meet the retirement income needs of future retirees. The system's current limitations in the areas of coverage, vesting, inflation protection, portability of pension credits and continuation of plans seriously limits its importance as a reliable source of retirement income for workers.

The Retirement Income Policy Act of 1985 (RIPA) takes an important step in improving retirement income security by encouraging the further development of the private pension system. Essentially, the legislation draws a clearer distinction between retirement and nonretirement plans and then revises the treatment of each type of plan. Plans designed to accumulate savings for retirement would be "retirement" plans while general capital accumulation plans would be "nonretirement" plans. Substantial participation and distribution requirements would be imposed on retirement plans to ensure the provision of an adequate benefit upon retirement. Nonretirement plans, on the other hand, would be viewed more as employee savings accounts and would be subject to less stringent requirements. Employers, however, would only be able to offer nonretirement plans to employees who are already covered under a retirement plan providing a "meaningful" retirement benefit. The bill also specifically addresses the need for reform of retirement plans in the areas of coverage, vesting, integration, contribution and benefit limits and distributions.

Coverage

In order to receive a pension benefit, an employee must be in covered employment. Approximately half of all workers today are covered by a pension plan. But, coverage varies greatly for different groups of workers. Workers who are unionized or employed by large firms are most likely to be covered. Part-time workers can be excluded as can new employees who are nearing retirement age. This pattern of coverage means that some groups of workers are much less likely to be in covered employment. For example, women make up two-thirds of the part-time workforce, are heavily concentrated in occupational areas where there are fewer pension plans and are most likely to work for small, nonunionized companies.

Lack of coverage results in workers retiring without pension benefits or with only a very small benefit from one employer. Currently, only about 25 percent of persons age 65 and over receive any private pension benefit. The Social Security Administration's most recent New Beneficiary survey shows that while the percentage of individuals receiving private pensions has increased, the amount of private pension income is still very low. For recent retirees, 38 percent of married couples and 26 percent of unmarried individuals receive some private pension income. But, half of the couples and two-thirds of the unmarried persons receive no more than $100 a month from this source.

RIPA would expand existing pension coverage by improving coverage in companies already sponsoring plans and encouraging the adoption of plans by small firms that have not offered them in the past. Current pension law requires only that 70% of the firm's eligible workforce be covered and allows employers to arbitrarily exclude whole categories of workers from coverage. Under the provisions of this bill, employers would be required to provide coverage for all employees with earnings below the Social Security taxable wage base. This represents an important coverage improvement. Further expansion is also needed to include coverage requirements for part-time and newly-hired employees nearing retirement age who are presently excluded.

The bill encourages the pension coverage in small firms by allowing firms with fewer than 25 employees to permit employees to make tax-free contributions to a Simplified Employee Plan (SEP) through voluntary salary reductions. Provided that the simplified non-discrimination rules insure adequate coverage, this provision could successfully result in the development of plans by companies that have not offered them in the past.

Vesting

Present law should be amended to shorten vesting periods. Currently, many plans use ten-year "cliff" vesting -- employees get no benefit unless they are in the plan ten years. In 1982, 87 percent of employees covered by medium and large plans had to work ten years to vest. In 1983, slightly more than half of all covered workers had vested in a plan. (Since only half of all employees are covered, this means that only 25 percent of the total working population had acquired a right to receive benefits.)

Job mobility is a fact of American life. It is extremely common among younger workers, but also prevalent among middle-aged and older workers. Of full-time male workers entering a job at age 25, 67 percent will leave before ten years; for those entering a job at age 45, 53 percent will not stay ten years. In 1983, 45 percent of men and 66 percent of women had less than ten years of service at their current jobs. Long minimum vesting schedules do not reflect the real work patterns of Americans. The mobile worker has as great a need for retirement income as the worker who stays with a single employer. Yet because of lack of vesting, the mobile worker may receive no pension or only a small pension from his/her last employer.

While immediate vesting, at least for a minimum benefit, may be the ultimate goal, it is clear that a vesting period significantly less than ten years is essential. RIPA takes a step toward that goal by requiring full vesting of plan participants after 5 years. Some may argue that the increased cost is too great, but the need to move toward greater protection far outweighs the costs involved. Donald S. Grubbs, a consulting actuary, estimates that three-year vesting would "create increases in costs for most defined benefit plans ranging from 0 percent to 10 percent of present plan costs and from 0.0 percent to 0.3 percent of compensation of covered employees." But, he goes on further to state that "the cost increase is small and affordable, and this disadvantage is outweighed by the need for early vesting."

Shortening vesting periods, however, is not enough to ensure adequate pension coverage. Even when a individual has vested, he/she may never receive a meaningful benefit because of Social Security/pension integration, lack of inflation protection, loss of accruals after age 65, pension plan terminations and the absence of a system of portability.

Integration

Many pension plans integrate Social Security and pension benefits, reducing an individual's pension by some percentage of their expected Social Security benefit. (Fifty-five percent of participants in medium and large plan are covered by plans that integrate.) While private pension plans must not overtly discriminate against lower paid employees, a plan may consider contributions to Social Security or expected Social Security benefits in determining benefit amounts. The end result of this practice is that lower paid employees may have their benefits substantially reduced or eliminated altogether.

While Social Security is weighted toward lower paid individuals, it is clear that those with low incomes need the supplementary retirement income provided by private pensions to maintain an adequate standard of living. The general thrust of tax code provisions and pension law has been to expand broad receipt of benefits. It is thus inconsistent and unfair to allow plans to integrate with Social Security so that lower paid workers receive little or no pension benefit. In addition, the fact that plan participants pay for pension benefits through reduced wages makes it difficult to justify denying earned benefits to lower paid workers.

The integration rules proposed under RIPA take a step towards restoring some of the pension benefits lost by many employees under current integration rules. RIPA would require that offset plans reduce a pension benefit by any uniform percentage of Social Security provided that the accrued benefit not be reduced by more than one-half. For excess plans, the accrual rate for earnings above the integration level must not exceed twice the accrual rate for earnings below the level. AARP commends the sponsors of S. 1784 for addressing the problem of integration to improve the retirement security of many lower income employees. Unfortunately, even under RIPA many employees will still find their benefits significantly reduced by integration. The Association believes that more must be done to alleviate the effect of integration on lower income employees.

Portability

A necessary corollary to any reforms in vesting and coverage is a system of portability that allows individuals to transfer vested pension credits. Currently, small vested benefits are often cashed out in lump sums and are not preserved to provide retirement income. With shorter vesting periods, this problem would be exacerbated, and the objective of providing more adequate retirement income frustrated.

One potential portability approach is taken by RIPA. This approach requires that any lump sum payment be deposited in a rollover IRA with access denied until retirement. Another possibility is the establishment of a central clearinghouse that could act as a "bridge" between pension plans, so that when workers changed jobs, funds could be transferred and maintained for retirement needs. Either approach would relieve the administrative burden placed on employers attempting to administer a number of small vested pensions.

The need for a system of portability is greatest for lower income workers, who are most likely to spend lump sum payments, and who are most in need of an adequate pension in the future. With a workable system of portability, earlier vesting becomes more practical and mobile workers in general will have the opportunity to receive a retirement benefit based on total years of employment.

Contribution and Benefit Limits/Distributions

Contribution and benefit limits serve to ensure more equitable coverage of all employees. Distribution and early withdrawal penalties are key factors in keeping pension funds in the retirement income stream. Clearly, these issues must be considered in the development of a national retirement income policy.

RIPA addresses each of these aspects of the private pension system and thus moves towards providing more equitable treatment of all workers, both in terms of coverage and dollar adequacy. First, RIPA proposes to revise the limitations on maximum contributions and benefits that apply where employees are covered by a combination of defined contribution and defined benefit plans. Specifically, RIPA would implement wage-related pension contribution and benefit limits, eliminate the combined limits that exist under current law, and establish a simplified relationship between contribution and benefit limits. Second, RIPA attempts to improve retirement security by adopting distribution rules that will help to keep pension funds in the plan until retirement. Under the bill, the distribution of benefits through periodic payments upon retirement would be encouraged. Additionally, the bill would allow participants to transfer their benefits directly into an IRA, with increased penalties for early withdrawal. Other forms of distribution would only be allowed under limited circumstances. These measures should work to ensure that benefits fulfill their intended purpose -- that of increased economic security throughout the retirement years.

RIPA clearly takes giant steps to significantly improve retirement security through a strengthening of the private pension system. However, no single piece of legislation can or should deal with all of the private pension issues of concern. Additional legislative initiatives are needed to address issues not included in RIPA. AARP appreciates the support of Senator Heinz and other members of the Finance Committee for related legislation designed to improve private pensions.

Lack of Inflation Protection

One factor mitigating against a retiree receiving a meaningful benefit is that the private pension system, as a whole, provides very little protection against inflation for those receiving benefits. Very few retirees are guaranteed any increase after retirement. For example, 49 percent of participants in large and medium plans were covered by plans that did not grant any ad hoc post-retirement increases in the 1978-1982 period, a time of high inflation. While many plans do provide ad hoc adjustments, only about three percent of all pension plans provide automatic inflation adjustments. Even these adjustments are usually limited to a maximum of about three percent a year. For Americans retiring at age 65, remaining life expectancy averages about 17 years. If one assumes an inflation rate of five percent, the average pension recipient will suffer a 56 percent reduction in purchasing power to his/her fixed pension in 17 years if benefits are not adjusted. Higher rates of inflation would be even more devastating.

If future retirees are to be better able to maintain their living standards throughout their later years, ways must be devised to mitigate the effects of inflation on private pension benefits. In addition, retirees must have the opportunity to take part in their pension plan's decision-making process to promote cost-of-living protection when funds are available.

Recovery of Excess Assets/Pension Plan Terminations

The goal of adequate retirement income from private pensions is also frustrated by the increasing trend of termination of pension plans for the purpose of recovering excess assets. Billions of dollars have been recaptured in the past few years, and current Pension Benefit Guarantee Corporation (PBGC) termination applications show that there is no slowdown. In fact, the number of terminations has almost doubled each year since 1979 and PBGC data indicates that approximately 600 plans with asset reversions of $1 million or more have been terminated since 1979. These reversions have resulted in the recapture of nearly $5 billion by plan sponsors and have affected over 700,000 employees. Approximately 200 additional terminations involving reversions are now pending at the PBGC involving about $2 billion and 300,000 employees.

This recapture of "surplus" funds by employers fails to account for the future needs and expectations of retirees and plan participants. Since an employer who terminates a plan is only required to pay participants the benefits they have accumulated to that point, retirees and workers in plans that have been terminated have their benefit amounts frozen at the current level. Not only does this eliminate the possibility of inflation adjustments for retirees in the terminated plan, it also often results in much lower eventual pension benefits for those still in the workforce.

The current accelerated trend of pension plan terminations is a clear signal that the law is inadequate. Several measures are now pending to correct this abuse, but there is no consensus on the appropriate solution to this problem. Therefore, AARP believes that an immediate moratorium on pension plan terminations with "excess" assets of more than $1 million should be enacted. During the moratorium period, Congress could analyze the proposals now pending and craft the most appropriate public policy response.

Post-65 Pension Benefit Accrual

Along with a stable Social Security system and expanded private pensions, public policy should encourage those who wish to continue working. Unfortunately, current law creates many disincentives to continued work. For example, pension law allows a change in the treatment of pension accruals for employees who continue to work beyond the normal retirement age. Current Equal Employment Opportunity Commission (EEOC) regulations, adopted from the Department of Labor, have allowed employers to give no additional pension credits to workers who continue employment beyond age 65. Recently, the EEOC rejected this interpretation as contrary to the Age Discrimination in Employment Act (ADEA) and proposed new regulations that would require accrual beyond age 65. Unfortunately, prompt action on finalizing the new regulation seems unlikely and nearly half of all pension plans continue to freeze pension credits at age 65.

Because of the EEOC's long delay in addressing this problem, AARP supports S.1427 which would require pension accrual beyond the normal retirment age. This legislation would remedy the current discriminatory treatment of older workers, and would add to the retirement security of older Americans. Given current economic and demographic trends, public policy ought to encourage, not discourage, labor force participation by older workers. Such increased employment activity would generate additional tax revenues at all levels of government, ease the strain on the Social Security trust fund and benefit older Americans who would be able to supplement their retirement income with employment income, which is more likely to keep up with inflation.

AARP supports enactment of an aggressive work promotion strategy designed to encourage and reward able-bodied older persons for continuing to work past age 65 and to discourage able-bodied older workers from retiring early. Components of this strategy would include: 1) the elimination of existing employment barriers, the most obvious of which is mandatory forced retirement based solely on age; 2) the elimination or substantial liberalization of the Social Security earnings limit for those 65 and over; 3) an increase in the delayed retirement credit in Social Security; 4) a reexamination of early retirement options in public and private retirement systems to see if they provide sufficient incentives for able-bodied workers to stay in the workforce; 5) elimination of the requirement that states reduce a person's unemployment compensation by the amount of any pension income received; and 6) encouragement of part-time work among older employees.

CONCLUSION

A national retirement income policy must recognize that Social Security, private pensions, employment and individual savings and investments all play a role in assuring adequate economic security for older Americans. Changes in any one of these components may very well affect all the others, thereby reducing or increasing retirement income for millions of people. National retirement income policy must foster both stability and adequacy.

Social Security will continue to be a primary retirment income source for many years to come -- current and future retirees need to be assured that the system will be financially secure and that benefit levels will be stable. But, the private sector's role in retirement income must be enhanced. Disincentives to employment among older Americans must be abolished. Ways to expand personal savings must be explored. Finally, the private pension system must be expanded to make it more accessible and fairer to workers in all parts of the economy. Thus the Association supports RIPA and its objective of strengthing retirement income policy in order to provide adequate retirement income for all of the nation's workforce. Although not a complete remedy to all private pension issues, the Association believes that the Retirement Income Policy Act is a significant move towards the development of an equitable and rational retirement income policy for both present and future generations of Americans.

STATEMENT ON BEHALF OF THE ASSOCIATION FOR ADVANCED LIFE UNDERWRITING AND THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Before the
Subcommittee on Savings,
Pension and Investment Policy
of the
Senate Committee on Finance

Hearing on the Retirement Income Policy Act
S.1784

February 11, 1986

On behalf of the Association for Advanced Life Underwriting (AALU) and the National Association of Life Underwriters (NALU), the following comments are submitted regarding selected provisions of the Retirement Income Policy Act (S.1784) (the "Act") pursuant to hearings held on January 28, 1986.

AALU is a nationwide organization whose membership consists of more than 1,200 life insurance agents and others engaged primarily in various aspects of life insurance marketing. Our members specialize in advanced life underwriting and collectively are responsible for annual sales of life insurance in excess of $2 billion, mostly in circumstances involving complex factual situations. Much of the work performed by our members relates to small businesses and deals often with qualified retirement plans and other employee compensation techniques.

NALU, which has a membership of 1,022 state and local associations with combined individual membership of over 135,000 life insurance agents, general agents and managers, joins AALU in the submission of these comments.

INTRODUCTORY COMMENTS

AALU and NALU are extremely concerned about Congress' approach to pension reform. In recent years, Congress has demonstrated a desire and a willingness to repeatedly revise the laws applicable to retirement and welfare plans. These revisions are made in spite of the fact that regulations have not been issued clarifying the earlier revisions and pension plans have only minimal guidance as to the interpretation of the applicable rules. This approach to pension reform is detrimental to the retirement security of millions of employees and Congress should act now to avoid its continuance.

Instead of addressing the subject of pension reform with immediately-effective legislation, Congress should structure a long-term study of the appropriate goals of pension plans. That study should analyze carefully the effects of any changes that might be enacted, considering especially the effect on the small business community, which is particularly sensitive to these repeated changes in statutory requirements. The study should be accompanied by an implicit agreement from Congress to thereafter refrain from changing the pension laws either as a means of enacting short-term revenue gains or as a means of imposing a new philosophy on the operation of pension plans. Any reforms that are enacted should be left in place for an extended period of time without substantial modification.

The frequency of legislative change has produced a continuing problem for employee benefit plans. Just since 1979 there have been seven major bills affecting those plans generally and numerous more in the five years before 1980. The legislation since 1979 includes the following:

1984

The Retirement Equity Act
The Tax Reform Act of 1984/Deficit Reduction Act

1983

Social Security Amendments Act

1982

The Tax Equity and Fiscal Responsibility Act
The Subchapter S Revision Act

1981

The Economic Recovery Tax Act

1980

The Multiemployer Pension Plan Amendment Act

In addition to these, several legislative proposals containing major pension revisions are currently pending before Congress, at least two of which, the Tax Reform Act of 1985 (H.R. 3838) and the pension provisions of the Budget Reconciliation Act, appear likely to be enacted in this session of Congress.

Further, the Internal Revenue Service, the Labor Department and the Pension Benefit Guaranty Corporation have a backlog of well over 100 regulation projects affecting employee benefits. Some of these regulation projects go back over 11 years to the original enactment ERISA. The Internal Revenue Service has not yet, for example, issued regulations on how employees who receive lump-sum distributions are to be taxed on those distributions.

The frequency of these changes adversely affects the stability of the retirement plan community and may well have long-term adverse affects on the retirement security of employees. Small employers particularly may be reluctant to adopt or maintain retirement plans in view of the frequency of change. It is in the small plan community where increased employee coverage by qualified plans is most needed. Congress should allow the retirement community a breather in which to digest current rules while developing long-term goals that will be consistently followed in future legislative efforts.

Congress has not always been prescient in analyzing the effect of changes that it enacts. Harm to employees often results from changes in pension rules, due to cutbacks and loss of coverage in employee benefits. One of the major thrusts of H.R. 3838, for example, is to restrict one of the more popular employer-sponsored retirement savings vehicles available to employees. This will cut down on the opportunity and willingness of employees to save for retirement, thereby diminishing the retirement income available to those employees. The addition of new nondiscrimination rules and reductions in benefit limits will likely cause employers to reduce available pension and welfare benefits and leave all employees with less coverage. Reducing the pensions of higher-paid employees often has a trickle-down effect on lower-paid employees through cutbacks in pension programs and benefits generally. Even if the employer continues its plan, often it will either fail to increase benefits, due to lack of availability of those increases to the more highly-paid employees, or will actually reduce future benefits for all employees.

Employers are harmed because of the substantial cost in updating retirement plans. These costs also adversely affect the willingness of employers, especially smaller employers, to maintain employee plans generally.

Given these overall goals and concerns, AALU and NALU applaud the Subcommittee for taking a well-balanced and long-term look at the goals of Internal Revenue Code retirement provisions. The Subcommittee's approach contrasts sharply with that contained in H.R. 3838, the Tax Reform Act of 1985. Under H.R. 3838, Congress is once again falling into its recent pattern of amending the pension provisions to inject short-term goals and to extract immediate revenue gains without appropriate consideration of the long-term affects on retirement security of employees. We strongly urge the Subcommittee to use its best efforts to have the full Committee remove the pension and welfare provisions of Title XI from H.R. 3838. If the tax bill is to be enacted, it should be enacted without once again sacrificing long-term retirement security for short-term gain.

DETAILED COMMENTS

Following are more detailed comments on selected provisions of the Act.

1. Adjustments to Section 415 Individual Limits

Under current law, both dollar and percentage limits are applied to defined contribution and defined benefit plans. The current dollar limitations are $30,000 for defined contribution plans and $90,000 for defined benefit plans. Those limits were $25,000 for defined contribution plans and $75,000 for defined benefit plans when ERISA was enacted.

Cost-of-living increases applied after the enactment of ERISA and continued until the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) but have essentially been suspended since then.

Under the Act, two major conceptual changes would be made to these limits. First, the relationship between the defined contribution and the defined benefit limits would be changed from a 1:3 ratio to a 1:4 ratio, thereby favoring defined benefit plans to a greater extent. Second, the limits would be tied to a wage-related concept through the Social Security taxable wage base.

AALU and NALU support the conceptual changes in these provisions of the Act. We believe that it is appropriate to provide more incentives for defined benefit plans than exist under current law and changing the ratios in §415 to permit a larger percentage of an individual's retirement income to come from defined benefit plans is one means of providing that incentive. In recent years, defined contribution plans have begun to play a much more dominant role in retirement planning for individuals than they have historically and adjustments in these ratios, as proposed in the Act, will help restore some of that historical balance.

Second, applying a wage-related concept to the §415 individual limits would be beneficial. It would restore indexing to a system which has been severely damaged through both cutbacks and lack of inflation adjustments and would put the private pension system on a parity with the Social Security system in terms of inflation adjustments. This will avoid the inevitable problem under current law of having the Social Security system take on a larger-than-appropriate share of the burden of providing retirement income to employees.

The major difficulty with the proposals in the Act, however, is that the foregoing is achieved at the expense of an additional cutback in the private pension system. The defined contribution limit, currently at $30,000, would be reduced to 50% of the taxable wage base and the percentage limitation, currently at 25% of wages, would be reduced to 20%.

Cutbacks in limits, even if delayed, exacerbate the problems of the pension system outlined in our introductory comments. The dollar limitations already are approximately half, on an inflation-adjusted basis, of what they were in 1974 and further cutbacks are entirely inappropriate. These cutbacks not only harm the employees directly affected but they reduce the incentive for qualified retirement plans and can lead to either failure of the corporation to make benefit increases or to actual cutbacks in future benefits or contributions under the plan. Qualified plans are often designed for the higher-paid employees and limitations on the amount of contributions that those employees can receive may lead to reductions in the contributions for other employees as well.

This problem could be largely solved within the conceptual framework of the Act by providing that the defined contribution dollar limit will not be reduced in order to achieve these changes. Thus, under our suggestion, when the new provisions of the Act went into effect, the defined contribution dollar limit would be the greater of 50% of the Social Security taxable wage base or $30,000. Thus, the dollar limitation would remain at $30,000 until such time as the taxable wage base reached $60,000.

Making the change in this fashion will substantially reduce the adverse impact on existing arrangements and will avoid the problems of destabilizing existing retirement arrangements. In addition, it provides the fairest way of transitioning from the current rules into the new rule in that actual cutbacks in benefit coverage are not required.

2. Section 415 Overall Limits

Under current law, an employer that maintains both a defined contribution and a defined benefit plan (or has historically maintained such a combination), must ensure that, in addition to complying with the individual §415 limits for each plan, an overall limit is satisfied. This overall limit has been generally recognized to be an extremely complex computation and provides many opportunities for mistake, except for truly sophisticated pension experts.

The Act, recognizing the deficiencies of the overall limit, would repeal the overall limit for all except top-heavy plans. Top-heavy plans would continue to be subject to the overall limits as under current law.

AALU and NALU support the elimination of the overall limit. By appropriately setting the limits for both defined contribution and defined benefit plans an overall limit is not necessary. In addition, having eliminated the overall limit will encourage employers to maintain both types of plans, probably the best mix of retirement planning that could be provided for employees.

AALU and NALU are, however, concerned over the provision in the Act which would retain the overall limit for top-heavy plans. This is particularly inappropriate since top-heavy plans perhaps have more difficulty in dealing with complex limitations, such as the overall limit, than other plans. Top-heavy plans are typically plans of small employers who have less pension expertise available to them and are most likely to have problems in complying with these limits.

Conceptually there is no justification for imposing more rigid limits for smaller plans than for larger plans. If the individual §415 limits have been appropriately set, then small plans as well as large plans should be entitled to utilize those limits.

3. Treatment of Qualified Cash or Deferred Arrangements

Under §401(k), employees can make voluntary employee contributions to save for their own retirement with substantial tax benefits. The Act preserves these tax incentives for §401(k) plans but requires that the §401(k) plan be included in a "retirement plan." One of the requirements for a "retirement plan" under the Act is that no distributions be allowed to the participant until age 59 1/2, even if the individual separates at an earlier time. Distributions may be made to the individual's IRA on an earlier termination of employment.

AALU and NALU support the continuation of §401(k) plans. These plans provide an important means of employee savings for retirement and will help ensure the retirement security of millions of employees. These plans, although relatively new, have become a major retirement savings vehicle and, if allowed to continue without undue government restriction, could provide substantially improved retirement security for employees.

However, in the interest of strengthening the continuing universe of §401(k) plans, the approach taken in the Act should be modified. Primarily, we are troubled by the retirement/nonretirement plan distinction and the implications that it has, especially for §401(k) plans. The concept of an individual not being able to take a distribution until age 59 1/2 (unless the distribution occurs through an IRA which involves penalty taxes) is troublesome and may undermine the very purpose for which §401(k) plans are most useful. Many younger employees will contribute a portion of their own salaries to a §401(k) plan so long as they have the assurance that they can withdraw their funds if needed. Depriving them of that assurance will make them hesitate to contribute to a §401(k) plan, especially if they have many years to go before retirement. If a substantial number of employees do not actively participate, then the plan will probably not be able to satisfy the IRS requirements and cannot be continued.

Currently there is no adequate statistical analysis of the affects of early withdrawal provisions in §401(k) plans. It is particularly inappropriate to legislate in this area without any reliable economic data on the actual rate of withdrawal that occurs under current rules. AALU's and NALU's experience, however, indicates that the rate of withdrawal is not substantial, that the ability to withdraw is more of a psychological value than a feature that is actually used. Once having contributed the money employees are very likely to leave it in the plan until retirement, thereby accomplishing the essential goal of retirement security. Also note that to the extent lower-paid employees are unwilling to contribute money to which they will have no access (until age 59 1/2), they will opt out of §401(k) plan participation. Under the discrimination rules, many existing §401(k) plans will have to be terminated for lack of participation among the lower-paid employees. This philosophy is also very likely to chill start-up of new plans. Mandating that employees leave their contributions in the plan until retirement will defeat the purpose of encouraging employees to save their own funds for retirement.

In addition, AALU and NALU suggest that the Act should be modified to use a different retirement age than 59 1/2. Age 59 1/2 came into the law through the IRA provisions but is inappropriate for qualified plans. Age 55 is normally considered the early retirement age and is a more appropriate age from which to base the various retirement measures that are used in current law. Consequently, AALU and NALU suggest that age 54 1/2 be used as the minimum retirement age rather than age 59 1/2. Appropriate changes should be made in both the Act and in current law to make the use of age 54 1/2 the general retirement age.

4. Effective Dates

A major feature of the Act is the delayed effective date rules that are provided. In general, the changes in the Act would not become effective within the first two years after enactment and thereafter would be included as plans are amended but in no event later than the end of 1990.

AALU and NALU applaud this approach. It will substantially improve the stability of retirement plans by giving employers an opportunity to incorporate these changes into their plans over a reasonable period. We urge that this approach be utilized whenever legislation is being proposed in the pension area and especially in H.R. 3838 since it would have a major disruptive effect on pension planning.

CONCLUDING COMMENTS

AALU and NALU remain very concerned about frequent changes in pension law that do not reflect careful, reasoned study of both the existing retirement system and the elements of an "ideal" system. We urge Congress to extract the pension area from the tax reform debate so that it will get the study and debate it needs to provide a stable system. AALU and NALU support, with modifications, many of the provisions in the Act, especially in the context of overall, long-term pension reform. As to the other provisions, we will need additional study time before reaching a fully reasoned conclusion. The Act does, however, have much to support it and is a substantial improvement in many ways over the provisions of H.R. 3838. We particularly urge that consideration be given to deleting the pension provisions in Title XI of H.R. 3838 and, if necessary, substituting at least those provisions in the Act that relate to the topics addressed in H.R. 3838. Further, we strongly urge that the effective date rules contained in the Act be incorporated into all pension legislation in the future, including H.R. 3838.

Respectfully submitted.

ASSOCIATION FOR ADVANCED LIFE
UNDERWRITING

NATIONAL ASSOCIATION OF LIFE
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STATEMENT OF BELLSOUTH CORPORATION FOR THE HEARING RECORD ON THE RETIREMENT INCOME POLICY ACT OF 1985, BEFORE THE U.S. SENATE COMMITTEE ON FINANCE'S SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY, JANUARY 28, 1986

BellSouth Corporation ("BellSouth") appreciates the opportunity to comment on the Retirement Income Policy Act of 1985 (the "Act") which was introduced by Senator Heinz on October 22, 1985.

I. Introduction.

BellSouth, a Georgia corporation, is one of the regional holding companies established as a result of the divestiture of American Telephone & Telegraph Corporation. Two of our subsidiaries, Southern Bell and South Central Bell, are corporations which provide local access telephone services to the American public in nine states: Georgia, Florida, Alabama, Mississippi, Tennessee, Kentucky, South Carolina, North Carolina and Louisiana. BellSouth and its eighty percent or more owned subsidiaries employ approximately 93,000 people of whom 50% are female and 20% are minorities. In addition, 27,500 retired employees participate in some or all of our employee benefit plans. Seventy-one percent of our employees are covered by collective bargaining agreements. We understand that we would be rated by Fortune 500 as the fourteenth largest corporation in the

United States were a rating based on assets. Our economic viability and employment opportunities are important throughout the Southeast.

A variety of qualified retirement plans are provided to employees of the BellSouth controlled group of corporations, although not all of our corporation's employees participate in all plans. Among our retirement benefit plans are two qualified defined benefit pension plans, a qualified thrift plan, a Code Section 401(k) thrift plan which we have adopted for our management employees, Individual Retirement Account-type plan, an employee stock ownership plan. BellSouth's nontelephone subsidiaries also maintain several qualified retirement plans.

II. Policy Goals of the Act.

BellSouth supports the ten (10) policy goals set forth in Section 2(c) of the Act. As a caveat, we stress the fact that employer sponsored retirement plans and individual retirement savings must remain voluntary. For example, goal ten states: "[t]o the extent possible, retirement income....should be sufficient to maintain an employee's preretirement standard of living throughout retirement." If this goal contemplates an employer retirement plan that automatically escalates with inflation, BellSouth would strongly oppose the Act. A retiree's ability to maintain the preretirement standard of living throughout retirement depends in large part on the general economy, his or her own personal savings, and, of course, the Social Security system; this ability is not a burden that private retirement plans can or should shoulder alone. Nevertheless, BellSouth supports tax incentives that encourage savings for retirement years.

III. Analysis of Specific Provisions.

A. Retirement Plan Coverage Required as Prerequisite for Nonretirement Savings Plan Coverage.

As you are aware, Section 104 of the Act, which amends the Employee Retirement Income Security Act of 1984 ("ERISA"), and Section 204 of the Act, which amends Section 401(a) of the Internal Revenue Code (the "Code"), generally states that an employer may not maintain a qualified "nonretirement savings plan" for or on behalf of its employees unless those same employees are eligible to participate in a "retirement plan," a new defined term applicable to qualified plans. A "retirement plan" is a plan which provides for distribution of accrued benefits with respect to a participant only upon (1) the later of the participant's attainment of any age at or above age 59 1/2 or the participant's separation from service, (2) the participant's disability, (3) the participant's death, or (4) any earlier date as long as any distributions commencing on an earlier date are made in a retirement income form, that is, in the form of some type of life annuity. *See* Act § 102.

Since one of the goals of the Act is to provide tax incentives for retirement income, we feel the technical separation of retirement plans and nonretirement savings plans is justified.

However, the requirement that an employer may not maintain a nonretirement savings plan unless at least one retirement plan is maintained will be counterproductive to the underlying goal of increasing coverage by a retirement income plan.

We recently adopted a Code Section 401(k)/thrift plan and we also maintain two defined benefit pension plans, one thrift plan, an employee stock ownership plan ("ESOP"), and an employer-sponsored individual retirement account-type plan pursuant to Code Section 408. As a general proposition, we believe BellSouth's ESOP, its Section 401(k)/thrift plan, and its thrift plan would fail to satisfy the requirements for a true retirement plan under the Act. The Code Section 401(k) plan allows for hardship distributions, the ESOP provides for in-service distributions at the times prescribed by the existing Code provisions, and the thrift plans are in the nature of pure profit-sharing plans and allow in-service distributions. Presumably, the provision of defined benefit pension plan coverage by BellSouth to its employees would allow BellSouth to continue to maintain the defined contribution plans mentioned above because BellSouth's defined Benefit pension plans exclusively provide for distributions in a "retirement income form". However, since the 401(k) plan would be a retirement plan by definition it is not clear how BellSouth's thrift plan would be classified.

BellSouth is attempting to expand its business into new areas and markets; continued maintenance of our existing corporate benefit program probably would be possible, albeit with extensive amendments and changes which may include plan separation. These new areas and markets have different competitive pressures, and BellSouth may desire to establish a different benefit package than it currently maintains in these new areas and markets. This has been proven true in our joint venture efforts to date. Thus, we oppose the requirement that retirement plan coverage is a condition precedent to nonretirement savings plan coverage.

Our employees currently benefit at retirement from prior contributions to those of our plans which probably would be characterized as nonretirement savings plans under the Act. We disagree with the assumption implicit in the Act that plans which provide for in-service distributions are not true retirement plans. Further, if the Act is enacted as proposed, we may be unable to maintain Code Section 401(k) plans. We find that employees are willing to contribute to Section 401(k) retirement plans in part because hardship distributions are available. Under the Act, we will be forced either (i) to amend the plan distribution provisions so as to create a retirement plan and, as a result, possibly lose sufficient participation by the lower paid, two-thirds or (ii) to eliminate before-tax contributions as the Act otherwise requires. While we realize that some members of Congress are dissatisfied with the ability of participants to gain immediate access to before-tax employee contributions in Code Section 401(k) plans, we believe this plan feature will materially increase the retirement income security of our employees. Our experience with our thrift plans is that employees do use the plans to save for retirement even though after-tax contributions to the thrift plans are withdrawn during the earlier years of an employee's service. Those employees who are electing to participate in the Code Section 401(k) features of our plans seem even more committed than our other employees to the goal of securing adequate retirement income through personal savings. Further, we feel this need can better be met through taxation at withdrawal instead of prohibitive rules which could reduce the number of qualified plans. This approach seems to be effective for the IRA Retirement plans.

Also, by establishing the provision of retirement income security as virtually the sole goal of the qualified plan system, Congress may inadvertently sacrifice other important social objectives. As Congress is aware, employers will not maintain qualified plans if the conditions imposed upon plan qualification are too onerous. The requirement that a "retirement plan" be provided as a condition precedent to provision of a nonretirement savings plan may constitute too onerous a burden on those employers who only are interested in providing nonretirement savings plan coverage as is demanded by its employees, and this requirement could lead to plan termination. In other words, some businesses have employees who are only interested in what have been characterized as "capital accumulation plans." This requirement seems to be more prevalant in new companies where the future is uncertain.

These companies have young employees who value current savings much more than retirement plans. Vesting and retirement are too far away to be of current interest. If so, we question whether or not Congress really prefers that these plans not be provided to employees. First, capital accumulation plans do provide an opportunity for employees to accumulate retirement income savings even if some participants withdraw those savings prior to retirement. The elimination of nonretirement savings plans used to accumulate personal savings runs counter to one of the Act's goals, that is, "retirement benefits provided by [Social Security] and employer-financed pensions should be supplemented by individual savings for retirement." Second, capital accumulation plans provide an opportunity for employees to accumulate contingency and emergency reserves. BellSouth believes that Congress should encourage employees to accumulate savings which may be used either to pay excessive medical expenses or to replace lost anticipated income, for example, as a result of disability. Third, capital accumulation plans represent an important source of investment capital for the American economy.

Furthermore, the Act would provide that a nonretirement savings plan would not be qualified unless every employee covered under the nonretirement savings plan is also covered under a retirement plan which provides meaningful retirement benefits. The Act defines a "meaningful retirement benefit" as an employer contribution of not less than three percent (3%) of compensation per year for a defined contribution plan. BellSouth currently has a Section 401(k) feature combined with its thrift plan for one of its unregulated subsidiaries. The Section 401(k) feature of the BellSouth thrift plan matches twenty-five percent (25%) of the first six percent (6%) of employee contributions. Since BellSouth believes that its retirement plan meets the demands of the employees and satisfies a goal of the Act, the Act's three percent (3%) minimum contribution rate requirement is too stringent. Instead, a lower percentage amount should be used in determining whether a retirement plan provides meaningful retirement benefits especially where only one pension plan is offered.

The retirement plan/nonretirement savings plan delineation raises a number of unanswered questions. For example, will salary reduction amounts be considered in determining whether a retirement plan provides meaningful benefits? Will a combination 401(k) plan and a nonretirement savings plan have to be considered two separate plans?

B. Retirement Income Requirements.

Section 102 of the Act, which amends ERISA as to participation and vesting, and Section 202 of the Act which amends the comparable provisions of the Internal Revenue Code (the "Code"), states generally that retirement plans must distribute benefits as retirement income. As noted, this requirement will discourage employees from participating in contributory qualified plans and will lead to a decrease in retirement income.

The hardship distribution rules currently applicable to Code Section 401(k) plans are an excellent example of past Congressional recognition of the multiple goals currently served by the qualified plan system. Code Section 401(k) plans may not make distributions prior to death, disability, attainment of age 59 1/2, separation from service, or the occurrence of a hardship. Although the Internal Revenue Service has not yet defined the term "hardship," practitioners generally believe that hardship includes excessive medical expenses, educational expenses, and the purchase of a principal residence. Satisfaction of either of these three liabilities seems at least as desirable as the accumulation of retirement savings and is deserving of favorable tax treatment. In essence, the hardship rules represent an acceptable balance of the need for retirement savings and other needs.

We are also concerned that the prohibition on retirement payments prior to age 59 1/2 unless payment is made in the form of an annuity creates problems for employees who retire before age 59 1/2 for health reasons. We recommend that the restriction on benefit payment form be waived for employees who retire early for health reasons.

C. Maintenance of Adequate Retirement Plan Coverage.

Section 103 of the Act, which further amends ERISA as to participation and vesting, and Section 203 of the Act, which further amends the comparable provisions of the Code, states generally that an employer who maintains a pension plan as defined in ERISA, must cover (1) either one hundred percent (100%) of the "relevant work force" or (ii) one hundred percent (100%) of the employees of any "allowable subdivisions," as long as the employees of the "allowable subdivisions" represent at least eighty percent (80%) of the total work force. Oddly enough, the "relevant work force" only includes those persons whose compensation is less than the Social Security taxable wage base. Thus, an employer satisfies the new coverage test if all of its employees who earn less than the Social Security taxable wage base participate in the plan and none of the other employees participate. Basically, an allowable subdivision is any separate business unit of the employer as distinguished by its locality of operation or its separate product line. Act § 203.

BellSouth's primary concern in the area of plan coverage is that all discrimination tests and coverage tests be premised upon the concept of "availability of benefits" and not upon the concept of "receipt of benefits." For example, BellSouth does not really support the current deferral percentage tests stated in Code Section 401(k) because those tests are receipt-based. BellSouth's Section 401(k)/thrift plans, as noted, use an employer matching concept, and we have difficulty assuring that adequate participation in the plan occurs at all compensation levels.

Similarly, BellSouth opposes the proposed rule contained in Section 103 and 203 of the Act which requires that sixty percent (60%) of employees eligible to participate in a plan which requires mandatory contributions actually participate. If the contributory plan is the retirement plan used to provide a "meaningful benefit" to employees, the required participation level is increased to seventy percent (70%). Congress must realize that each employee has a different set of financial needs, resources, and interests and that the desire for retirement savings at any particular moment in time does not necessarily conform to Congress' desires. High levels of required participation will result in plans being disqualified and will result in a decrease rather than an increase in coverage.

BellSouth provides employer matching contributions to all employees on an equal percent of pay basis, BellSouth encourages all employees to participate, and no additional burden should be imposed upon us in effect to compel participation by employees.

We also believe that the eighty percent (80%) coverage rule for the "relevant workforce" potentially limits diversification of some companies, including BellSouth. Existing corporations with established benefit programs which expand into growth industries will face severe competitive problems if they are forced to establish and maintain pension plan benefits in excess of the competition. Certainly more than twenty percent (20%) of a corporation's work force may be employed in growth areas where institutional-type benefits are not customary. Moreover, capital accumulation plans are ideally suited for employees in growth industries, yet the Act places severe restrictions on those plans.

BellSouth would like the definition of the term "allowable subdivision", to be broad enough to allow a large corporation to start a new line of business in a related area with minimum long-term benefit liabilities. We suggest that a business which is operated as a separate profit center or which maintains separate profit-loss statements should be considered an "allowable subdivision." The one hundred percent (100%) coverage rule only should be applied to those employees employed by a member of a controlled group of corporations or businesses, and joint ventures and partnership-type companies should not be aggregated with the joint venturers or partners in determining whether or not an employer has satisfied the one hundred percent (100%) coverage test for "allowable subdivisions."

Finally, we believe that the protected group provided for in the Act, that is, those employees earning less than the Social Security tax base, is both too broad in certain cases and too narrow in other cases. For example, in a small entrepreneurial company which needs to conserve resources, the definition of the protected group may force the employer to provide benefits to ninety-nine percent (99%) of its employees, whereas in certain large companies which have excluded unionized employees the definition of the protected group will only require the employer to provide coverage to a small percentage of its employees. BellSouth strongly supports maintenance of the existing Code Section 410 coverage rules.

D. Limitations on Contributions and Benefits.

Section 214 of the Act establishes new Code Section 415 limits for benefit accruals under defined benefit plans and contributions to defined contribution plans, which limits are based upon the Social Security taxable wage base. Specifically, contributions to a defined benefit plan on behalf of a participant are limited to the lesser of one hundred percent (100%) of compensation or two hundred percent (200%) of the contribution and benefits base under Section 230 of the Social Security Act. Act § 214(b). For defined contribution plans, contributions on behalf of a participant are limited to the lesser of twenty percent (20%)

of compensation or fifty percent (50%) of the Social Security taxable wage base. Act § 214(c).

On a positive note, we are initially encouraged to see Code Section 415 limits that are based on a factor responsive to inflation. However, BellSouth believes that the above-stated limitations on benefit accruals under defined benefit plans and contributions to defined contribution plans are too low. The proposed limit on benefit accruals under defined benefit plans could lead to reduced benefits for the rank-and-file as defined benefit plans are adjusted to the new maximum levels. Reducing contributions to defined contribution plans will negatively impact capital formation. We recommend that the defined benefit plan limit be the lesser of one hundred percent (100%) of compensation or two hundred fifty percent (250%) of the Social Security taxable wage base and that the existing defined contribution plan limits be retained. Compensation and benefit programs for highly compensated employees are established entirely by market forces which are beyond the individual employer's control. To the extent that BellSouth is unable to provide an adequate qualified retirement plan benefit to secure an employee's employment with BellSouth, nonqualified alternatives must be explored. The Code Section 415 limits have already been lowered so that some employees which ERISA originally was designed to protect are limited as to their qualified benefits. The proposed limits will probably force BellSouth and others to provide supplemental benefits to other employees, which benefits will be provided without the protections of ERISA's minimum funding and vesting requirements.

As explained above, the use of a low level of the Social Security taxable wage base to establish the Code Section 415 limits suggests a misunderstanding of the compensation structure of large corporations. This misunderstanding appears again in Section 214(c)(3) of the Act, where a special Code Section 415 limit is placed upon qualified cash or deferred arrangements. Basically, contributions made pursuant to a qualified cash or deferred arrangement are limited to twenty-five percent (25%) of the contributions and benefit based under Section 230 of the Social Security Act. Many of our employees who are not really business owners, executives, or highly compensated employees, given our compensation range, could be adversely affected by this limit. We understand that Congress is attempting to encourage the provision of qualified retirement plan benefits to rank-and-file employees while discouraging or preventing "unnecessary" tax losses through income deferrals by high-paid executives; however, we believe that the proposed additional limit on cash or deferred contributions strikes the wrong balance between those two competing goals.

Finally, Section 214(c)(4) of the Act limits annual additions to a nonretirement savings plan on behalf of a participant to the lesser of twenty-five percent (25%) of the Social Security taxable wage base or ten percent (10%) of the participant's compensation. BellSouth opposes this limit. From a practical standpoint, the limit will unnecessarily complicate plan administration. In addition, nonretirement savings plans build capital which is needed for economic expansion. All earnings and assets in nonretirement savings plans will be taxed as ordinary income when distributed. Section 214(c)(4) of the Act would unwisely discourage employers from accumulating pension funds and would be administratively burdensome.

E. New Vesting Rules for Qualified Plans.

Section 121 of the Act, which amends ERISA, and Section 221 of the Act, which amends the Code, require (1) that a participant in a retirement plan have a nonforfeitable right to one hundred percent (100%) of his or her accrued benefit after no more than five years of service and (2) that a participant in a nonretirement savings plan have a nonforfeitable right to one hundred percent (100%) of his or her accrued benefit after no more than one year of service.

BellSouth does not support five year vesting for defined benefit plans. Defined benefit plans are designed to award career employees for their contributions to the long-term success of the corporation. A five year vesting schedule will prevent BellSouth from using its defined benefit plan to encourage employment longevity. BellSouth recommends that a ten year vesting schedule be retained for defined benefit plans. BellSouth supports a five year vesting schedule for defined contribution retirement plans. The five-year cliff vesting rule would produce many small, vested accounts in a defined benefit plan having as many participants as BellSouth's plans do. Our objections to the proposed rules and its additional administrative costs would be less strenuous if the distribution rules are relaxed such that we could at our option, distribute small accounts to participants and reasonable amounts to an individual retirement account (levels to be set and indexed). The Act, of course, takes the opposite approach, requiring the employer to distribute amounts from retirement plans only by transfer to an individual retirement account. The expense inherent in the transfer, and especially the risk inherent in the employer's choice of an account should the participant refuse to designate one, will force employers to retain costly small account balances. Maintenance of small accounts in plans which are as complex and as sensitive to employees' needs as ours creates significant administrative costs.

BellSouth could also support a shorter vesting schedule for nonretirement savings plans, but the one year vesting rule for nonretirement savings plans is unreasonable. BellSouth would support a five year vesting schedule for nonretirement savings plans. The purpose of an extended vesting schedule is to allow the employer to build employee loyalty in part through its benefit program. Moreover, the administrative costs associated with small accounts will increase under this vesting schedule since employee turnover often occurs on or around the first anniversary of the employee's commencement date. The Act does not clearly state whether class year vesting may be used. If class year vesting is a viable alternative, BellSouth would support a schedule shorter than 5 years. Finally, we question which vesting schedule must be used for a combination retirement plan/nonretirement savings plan.

Under the rules as we understand them, the combined plan would have to operate as if it were two separate plans to avoid conflicting vesting schedules, participation requirements and contribution minimums.

As an aside, the Act could inadvertently erode the federal tax base in a small way, since forfeitures decrease as vesting schedules shorten and because most plans offset future deductible employer contributions by the amount of forfeitures.

F. Loans from Retirement Plans Treated as Distributions.

Section 215(b) of the Act treats loans from retirement plans as distributions. This change will discourage young employees from participating in contributory qualified plans. Reduced participation by young employees will reduce the allowable contributions of more highly compensated older employers, and thus generally reduce retirement plan coverage. Qualified plan loans provide contingency reserves without long term impairment of the amount of a participant's retirement savings. BellSouth strongly recommends that loans be allowed.

G. Pension Integration.

Section 231 of the Act generally prescribes the extent to which a plan may be integrated with Social Security. In excess plans, contribution percentages and accrual rates for earnings above the integration level may not exceed two times the contribution percentages or accrual rates for earnings below the integration level. In offset plans, pension benefits may be reduced by any uniform percentage of Social Security benefits provided that no participant's accrued benefit after the reduction is less than half of the participant's accrued benefit without the reduction. These limits simply do not recognize a corporation's Social Security expense. BellSouth believes that an integration method based on the employer's Social Security contribution is a better alternative. For example, in an excess plan, the accrual above the Social Security taxable wage base could be increased by the employer's percentage contribution for Social Security. In an offset plan, the accrual could be reduced by the employer's contribution to Social Security or, at a minimum, by the Old Age Survivor portion of the employer's contribution.

The Secretary of the Treasury is given the authority to develop regulations in this area. The proposals represent significant changes in the integration rules, and many important issues will arise. BellSouth recommends that solutions to these issues be provided by Congress rather than by regulators.

H. Denial of Special Tax Treatment for Lump Sum Distributions.

Section 241 of the Act eliminates ten year forward averaging for lump sum distributions from a qualified plan. Qualified plan participants have made distribution decisions in the past based, in part, on the prospect of future favorable tax treatment for lump sum distributions. To eliminate ten year forward averaging for lump sum distributions of existing plan balances would cause unexpected hardship to many individuals. At a minimum, BellSouth recommends that this change be made on a prospective basis only.

Section 241 of the Act also eliminates capital gains treatment for lump sum distributions. Again, BellSouth recommends that this change be made on a prospective basis only.

I. IRA Contributions Offset by 401(k) Contributions.

Section 213 of the Act reduces an individual's annual permissible deduction for a contribution to an IRA by the amount contributed on behalf of the individual by the individual's employer under a cash or deferred arrangement. BellSouth supports a coordinated limitation, but feels a dollar limit, such as proposed in HR 3838, will achieve the same goal in a less administratively burdensome manner. Also we feel that an individual with an unemployed spouse should be allowed to contribute $2,000 to a 401(k) Plan without any corresponding reduction in contributions to an IRA. Under this revised rule, the IRA deduction for individuals with unemployed spouses would be offset dollar for dollar only after exceeding the individual contribution limit of $2,000.

J. Twenty Percent Penalty (20%) on Early Withdrawals from an Individual Retirement Account.

Section 242 of the Act increases the penalty on early withdrawals from an IRA from ten percent (10%) to twenty percent (20%). BellSouth feels that this increase is unwarranted. A premature distribution from an IRA is taxed as ordinary income.

With a twenty percent (20%) penalty, an individual in the thirty percent (30%) incremental tax bracket will pay one-half (1/2) of a premature distribution in taxes. Individuals open IRAs to save for retirement. The fact that an individual experiences a change in financial status and must withdraw a portion of his IRA savings does not mean that the individual has abandoned or should be forced to abandon retirement savings altogether. The current ten percent (10%) penalty is enough to discourage withdrawals without being so great that an individual forced to make a premature withdrawal is punished for attempting to save for retirement. BellSouth recommends that the ten percent (10%) penalty on early withdrawals be maintained.

Testimony of

BPW/USA, The National Federation of Business and Professional Women's Clubs, Inc.

on

Women and Private Pensions

BPW/USA, the National Federation of Business and Professional Women's Clubs, Inc., founded in 1919 to improve the status of women in the workforce, is dedicated to promoting full participation, equity and economic self-sufficiency for working women. Today, with a membership of 140,000 women and men, there are 3,500 BPW/USA local organizations with at least one organization in every Congressional district in the United States. As the voice of working women and in keeping with our objectives, BPW/USA has worked for more than a decade for pension reform. More specifically, we seek changes which will make the private pension system more responsive to the needs and work patterns of American workers, and particularly, women workers.

Historically, pensions have been viewed as gifts toward workers in "recognition of 'long and faithful service,' and...no legal rights were thereby given to employees who became beneficiaries of a plan." That view, a product of the 19th century work ethic, was not inclusive of women and should no longer be applicable in today's society where job mobility is common. More recently, Congress has been forced to intervene to protect workers from fraud and corruption within the private pension system. A little more than a decade ago, Congress passed major legislation -- the Employee Retirement Income Security Act (ERISA) -- to protect workers from just such abuse.

In 1984, Congress passed another piece of legislation, the Retirement Equity Act (REA) to change some provisions of ERISA which negatively affected women. REA lowers the minimum vesting age from 25 to 21; requires a spouse's written permission before an employee waives survivor benefits; and liberalizes rules related to breaks-in-service. While the law is clearly a first step toward retirement equity, further changes are needed to expand pension protection to all workers.

The present pension system rewards workers who have steady careers with low job mobility and substantial earnings. Women, who comprise 43 percent of the total labor force, are largely excluded from such a system. The typical woman worker has a very different employment pattern; she is in a female-dominated occupation, earns less than the average man and changes jobs more frequently. The media attention focused on the career woman in no way reflects the current status of working women. Most still earn only 63 cents for every dollar earned by men. This is a major factor contributing to the feminization of poverty generally and to the poverty of older women.

In 1984, 15 percent of women 65 and over were living at or below the poverty line compared with 8.7 percent of men.

The numbers of older women in poverty will continue to grow as the income gap between women and men 65 and over continues to widen. The average total annual income for women 65 and over was $4,757 in 1981 while for men it was $8,173. In 1983, although the average total income for both women and men rose — $5,599 for women and $9,766 for men -- so did the disparity between the two, by $751. Similarly, the gap is also increasing between the numbers of men and women receiving any private pensions. In 1983, only 11 percent of women 65 and over received private pensions or annuities while 30 percent of men received some benefits. For women, this represented a meager .5 percent increase from 1981 compared to a more than 2 percent increase for men over the same time period. These statistics clearly reveal that the current pension system does not adequately protect many American workers, least of all women.

Private pensions represent a critical and increasingly necessary component in maintaining an adequate standard of living at retirement. Private pensions, social security and personal savings combined are needed to provide adequate retirement income for American workers. Social security benefits alone are inadequate, yet, 60 percent of women living alone or with an unrelated person (Social Security and the Changing Roles of Men and Women, p. 183, HEW, 1979) depend on these payments as their only source of income. Clearly, women need the income that pension benefits can provide.

Until the millions of employed women in America have access to adequate private pension benefits, they will continue to make up a disproportionate number of those older Americans living in poverty.

Specific reforms are needed in the areas of coverage, vesting, integration, and portability to make the private pension system truly fair.

I. Coverage

Comprehensive coverage is an important step toward retirement equity. Women workers, however, haven't had equal access to pensions largely because they have been clustered into lower-paying, female-dominated jobs -- jobs that are not likely to offer pension\ benefits. Women continue to be disproportionately represented both in low-paying jobs and in occupations with the lowest numbers of pension plans -- trade (only 37 percent of workers covered in 1979) and service (only 33 percent covered). The most recent figures, compiled by the Bureau of Labor Statistics in 1981, reveal that women comprise 80.5 percent of all clerical workers; 62 percent of all service workers; and 45.4 percent of all sales workers. Fewer than half the women in these jobs will be covered by pension plans.

The stratification of women into these lower-paying jobs translates into less pension coverage and ultimately no pension benefits for many women workers. In addition, employers can exclude certain classes of employees (secretaries, for instance). Since women occupy most clerical and other low-paying positions, they are often the victims of these "exclusionary clauses." BPW/USA strongly supports amending ERISA to prohibit "exclusionary clauses" and we urge policy-makers to explore new ways of encouraging employers to provide pension plans for employees.

Older workers also find themselves in precarious coverage situations. Currently, many programs provide coverage to all workers except those who start work within five years of the plan's normal retirement age. Further, after age 65, accrual of benefits is usually frozen even if the employee continues working. Arbitrary age discrimination in coverage is unwarranted and should be eliminated. In addition, BPW/USA supports giving credit toward pension plans for employees who work after the plan's normal retirement age.

Part-time workers--mostly women--are often the victims of discriminatory coverage practices. Women are more likely to work part-time because of familial responsibilities. Department of Labor statistics show that "more than one-fourth (28 percent) of all women workers held part-time jobs in 1981; a great majority of them (78 percent) were employed on a voluntary part-time basis.

About 66 percent of all part-time workers were women." Yet, part-time workers must work at least 1,000 hours per year to receive pro-rated credit. BPW/USA supports pro-rated credit toward vesting if employees work 500-999 hours per year.

II. Vesting

Minimum vesting requirements must be lowered. (Vesting is the legal, non-forfeitable right to receive accrued benefits at retirement.) Current vesting practices disqualify many full-time and part-time workers, especially women. While 47 percent of the workforce is covered, only 22 percent actually receives pension income. For women, the situation is worse -- only 11 percent of the women ostensibly covered ever receive a pension payment. This disparity is partially the result of outdated vesting practices. In 1982, the Bureau of Labor Statistics reported that 88 percent of workers covered by medium and large-sized firms had to serve 10 years to vest their right to a future benefit. In January 1983, 50 percent of the full-time civilian workforce over 16 had worked for their current employer 4.4 years or less (men--5.1 years, women--3.3 years), and 73 percent had worked for their current employer less than 10 years (men--67 percent, women--79 percent).

Current vesting practices do not take into account job mobility which, as the Honorable Geraldine Ferraro wrote in Pensions and Investment, is "no longer a sign of irresponsibility or lack of commitment. It's an economic reality that should not be punished by an insecure old age." To ensure that workers who are covered will be vested, BPW/USA supports five-year vesting with a phase-in to three-year vesting.

III. Integration

Even if coverage is extended and vesting requirements lowered, workers who qualify for pensions may not actually receive any benefit because of pension integration. This widespread, though rarely mentioned, practice allows companies to take social security into account when calculating an employee's pension benefit. Integration is a form of discrimination against lower paid employees. The amount of money "integrated out" of lower-paid employees' pensions goes back to compensate higher-paid employees.

One method of integration, the offset method, illustrates the devastating effects of pension integration. According to current law, an employer can deduct up to 83 1/3 percent of social security benefits from pension plans, but generally they deduct 50 percent. The following example illustrates how this works:

Mary Smith (fictional character), who earned $15,000 yearly, was about to retire at age 65 after working 10 years for the Typewriter Corporation. Her employer will calculate her pension benefit by multiplying the following elements together: 1) a percentage based on the highest five years of average monthly earnings, which in this case is 1.2 percent; 2) the number of years she's worked for the company; and 3) her average monthly earnings over the last five years ($1250). When multiplied together, the pension benefit payment that Mary Smith is entitled to is $150 per month. Since her plan is integrated, her company will subtract 50 percent of her monthly social security benefit, which is approximately $544, from her pension benefit. When the company subtracts 50 percent ($272) from her pension benefit, ($150), Mary Smith is left with no pension. Many workers find themselves in similar situations because of integration. This practice has worked to the detriment of lower-paid workers, most of whom are women. Since many workers are harmed by integration, BPW/USA believes that the practice should be eliminated.

IV. Portability

Employees also need pension benefit protection when they leave a job after they have vested with their employer. Developing a portable pension plan is one way of protecting employee's benefits.

Donald Grubbs, in his testimony before the Select Committee on Aging in 1983, argued that "a federal portable pension system is needed now to preserve pensions that are vested under current law." Further, he explains that "if vesting requirements are accelerated for all plans, producing more small vested pensions, the need for a federal portable pension system would be even greater." The lack of portability, he says, often causes individuals to receive smaller pension benefits. For women workers, the problem is even more acute. BPW/USA supports instituting "portability" of vested pension credits from one plan to another with incentives to employers who implement this procedure.

All American workers can benefit from comprehensive pension coverage. Problems with the current private pension system can be resolved through implementation of these reforms. With these changes, comes the realization that pensions are not gifts -- they are earned benefits that replace lost wages. These earned benefits are subsidized by all Americans through the tax system and should be distributed fairly. Congress has the responsibility for ensuring that no worker, because of pension inequities, be faced with poverty in later life.

E

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Washington, D.C.

ECFC is a non-profit membership organization concerned with flexible compensation programs for corporate employees.

LA
FYI

February 14, 1986

Dear Senator:

The Employers Council on Flexible Compensation is a national, non-profit organization composed of over 170 members -- employers who sponsor flexible compensation programs, including cash or deferred arrangements (such as 401(k) plans), employers interested in flexible compensation, and firms who assist employers in the design, implementation and maintenance of such programs. Enclosed is our testimony on S. 1784, the Retirement Income Policy Act, submitted in conjuction with Finance Committee hearings January 28 chaired by Senator Heinz.

Retirement benefits are important to every working person in the United States; development of a national policy on these benefits is imperative. By their very nature, retirement programs require long-term planning and funding and should not be subjected to the vagaries of revenue needs such as those present in tax reform.

Specifically, we are concerned about provisions which would discourage individual retirement savings through tax-advantaged vehicles like IRAs and 401(k) plans. According to an ECFC survey done in May 1985, of the nearly half a million employers who sponsor 401(k) plans, more than one-third offered no other retirement plan. 401(k) plans embody our three-part system of providing for retirement -- the government provides tax deferral, the employer serves as administrator and usually provides contributions, and the employee contributes a portion of his current income.

Before 401(k) plans are curtailed, we hope you will consider the savings incentives that working Americans now enjoy. Our retirement income policy should recognize the role of individual savings and encourage savings. Congress should reaffirm our national commitment to individual savings for retirement.

Thank you for your consideration.

Sincerely,

Kenneth E. Feltman

STATEMENT

OF THE

EMPLOYERS COUNCIL ON FLEXIBLE COMPENSATION

ON THE RETIREMENT INCOME POLICY ACT

The Employers Council on Flexible Compensation is a national, non-profit organization composed of over 170 members -- employers who sponsor flexible compensation programs, including cash or deferred arrangements (CODAs or 401(k) plans), employers interested in flexible compensation, and firms who assist employers in the design, implementation and maintenance of such programs. We welcome the opportunity to join in the Committee's efforts to formulate a national retirement income policy and to offer our comments on the Retirement Income Policy Act (S. 1784).

Our members unanimously support S. 1784's goal of stating a national retirement policy. Although our members often hold diverse views with respect to specific current and proposed laws governing retirement plans, all agree that a stable legal environment is a top priority in the employee benefits field.

Because of the importance of retirement benefits to every working person in the United States, a national policy on these benefits is imperative. Retirement programs require long-term planning, by both the employer and the employee. Subjecting an area of such broad-based and long-term importance to the vagaries of revenue needs has imposed substantial costs upon employers and employees.

In August of this year, even as Senator Heinz and Senator Chaffee worked on this much-needed legislation, ECFC's President, Martin Bael of Eastman Kodak, published an article emphasizing the desperate need for a benefits social and tax policy. He noted that the "few in government who continue to champion [a national policy] should be warmly and vigorously encouraged in their efforts". In that spirit, ECFC wishes to warmly and vigorously encourage this Committee to arrive at a national policy and would like to assist you by sharing our experience in the benefits field and by offering our comments on S. 1784.

The three pillars which support the retirement income of working people -- Social Security, an employer-provided retirement plan and individual savings -- are all, to some extent, subject to erosion by economic forces and government policies beyond the control of individuals. By encouraging individual savings through tax-advantaged vehicles like IRAs and 401(k) plans, the government has helped individuals become less dependent on Social Security and less vulnerable to the ability or willingness of their employers to offer retirement plans.

Of the nearly half a million employers who, as of May, 1985, sponsored 401(k) plans, more than one-third offered no other retirement plan. Without the 401(k) plan, employees of those companies would have only Social Security and after-tax savings to look to for retirement income.

Many companies have neither the financial ability nor the corporate life expectancy to provide traditional retirement benefits and have accommodated the needs of their employees for retirement savings by offering CODAs. Start-up companies, for example -- the computer and high technology companies whose growth is so important to our economy -- can often not count on funding a plan over the long-term. For workers making their careers in this highly mobile field, 401(k) plans have been a boon to retirement planning.

Tax-deferred savings vehicles have benefited not only the savers themselves, but have encouraged new savings and capital formation. As small savers become small investors through 401(k)s and IRAs, American business has received an infusion of capital and ownership of our corporations has become more widely diffused.

Now, these policies and benefits are being placed in jeopardy by efforts to reduce the national debt and to reform the tax structure. Before measures affecting 401(k) plans are taken, we hope you will consider the policies which have led to the structure we have and to the benefits we presently enjoy.

Of the provisions in S. 1784 that affect 401(k) plans, the one which would be most disruptive of the current policy encouraging individual savings for retirement is the limit imposed on deductible contributions to an IRA for individuals who participate in a 401(k) plan. Increased individual savings lessen dependence on government-provided retirement income through Social Security. By limiting tax incentives for individual retirement savings, we are sacrificing future economic benefits to immediate revenue concerns. We ask the Committee to impose limits on tax-deferred savings only after considering the long-range consequences to our national retirement income policy.

The effect of S. 1784 on the level of pre-tax individual savings is a major issue to be determined in light of our national retirement income policy; S. 1784 also addresses narrower issues with respect to 401(k) plans. We suggest that the Committee reevaluate the need for complex nondiscrimination provisions in light of the proposed limits on contributions. Limiting 401(k) contributions to 25% of the Social Security taxable wage base, as S. 1784 provides, virtually removes the potential for disproportionately large contributions on behalf of highly-compensated employees. We suggest the Committee take this opportunity to eliminate the administratively burdensome tests and thus encourage more employers to establish and retain

401(k) plans. To the extent that any nondiscrimination tests are necessary, ECFC supports S. 1784's retention of the current 401(k) nondiscrimination tests. Although these tests are complex and unwieldy, employers have had some experience with the current tests and have developed programs to apply them. The imposition of entirely new tests, as in the Tax Reform Bill of 1985, would substantially burden employers and yield only negligible benefits, if any.

Although the limits on withdrawal and loan privileges proposed in S. 1784 are laudable to the extent that they make sure savings are available at retirement, they may discourage individual savings, particularly among lower-paid employees. Employees recognize the need to save for their retirement, but are generally reluctant to risk their ability to handle a current family financial emergency. The availability of withdrawal and loan provisions enables employees with little discretionary income to save for their retirement on a pre-tax basis.

Our retirement income policy should recognize the role of individual savings and our laws should encourage savings. 401(k) plans embody our three-party system of providing for retirement -- the government provides tax deferral, the employer serves as administrator and often provides matching or other profit-sharing contributions, and the employee contributes a portion of his income. As Congress considers for the first time our retirement income policy, the commitment to individual savings for retirement should be reaffirmed to the general public. Savings can be encouraged most appropriately through the increasingly popular 401(k) vehicle.

STATEMENT OF JOHN B. HUFFAKER FOR INCLUSION IN THE RECORD OF THE HEARING ON S.1784 BEFORE THE SAVINGS, PENSIONS AND INVESTMENT POLICY SUBCOMMITTEE OF THE COMMITTEE ON FINANCE

My name is John B. Huffaker. This statement is being submitted in lieu of a personal appearance with the request that it be included in the hearings in the same manner as if I had appeared.

I am submitting this in my capacity as counsel for the following corporations and their Employee Stock Ownership Trusts:

1. Cataract, Inc.
   660 Newtown Yardley Road
   Newtown, Pennsylvania 18940

2. Commercial Office Environments, Inc.
   8760 George Palmer Highway
   Lanham, Maryland 20801

3. Kiesling-Hess Finishing Co., Inc.
   300 West Bristol Street
   Philadelphia, Pennsylvania 19140

All three share these characteristics:

A. The companies are closely held.

B. In each case, a controlling shareholder desired to withdraw. The sale of his stock to the ESOT was the only practical alternative to the sale to a competitor and a probable loss of jobs.

C. The ESOTs own over 50% of the outstanding stock and are the principal retirement plan of the company.

ESOTs are frequently the only feasible way for a small corporation to provide substantial retirement benefits. In other words, if the ESOT alternative was not available, there would not have been retirement plans with the potential to pay adequate retirement income in any of the corporations. Thus, the ESOTs are basically defined contribution plans that are principally invested in employer securities and which acquired most of the stock by leveraged purchases. Thus, these ESOTs are a valid way not only to provide retirement benefits for a segment that might be uncovered but also accomplish the American dream of giving the employee of the small corporation a significant investment in the business.

We endorse the general goals of the bill. However, we note that the bill does not address the characteristics of the ESOT that are not different from other defined contribution plans. There are detailed provisions in present law relating to ESOTs and H.R. 3838 proposes major changes. Some of these changes are completely unworkable for the ESOT of a closely-held corporation.

At such time as the Subcommittee deems it appropriate, we shall be glad to submit detailed material relating to ESOTs of closely-held corporations or to meet with the staff to discuss appropriate provisions for ESOTs. We fully endorse the underlying recognition that the rules for retirement plans should be changed as infrequently as possible since the plans involve very long range planning by employers, the trustees and the employees and by their nature have limited flexibility. A corollary to this recognition is that any changes should be carefully analyzed before enactment. H.R. 3838 suffers from being on a schedule that will not permit the consideration that the subject matter deserves.

Legal Defense Fund

NAACP LEGAL DEFENSE AND EDUCATIONAL FUND, INC.
99 Hudson Street, New York, N.Y. 10013• (212) 219-1900

806 Fifteenth Street, N.W., Suite 940
Washington, D.C. 20005 • (202) 638-3278

February 10, 1986

Senator John Heinz
Subcommittee on Savings, Pensions and
Investment Policy
Senate Committe on Finance
277 Rayburn Office Building
Washington, D.C. 20510

Dear Senator Heinz:

The NAACP Legal Defense and Educational Fund is pleased to submit the enclosed testimony regarding S. 1784 -- The Retirement Income Policy Act of 1985. We commend the Committee for attempting to alleviate many of the pension inequities that are now found in the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code of 1954. These inequities particularly impact upon this nation's workers who have held low-wage jobs throughout their work lives.

The Legal Defense Fund is concerned about the increasing rates of poverty among Black families. Far too many elderly Blacks are among this country's very poor and pension equity will improve future conditions for many workers. Particularly at risk of poverty from the cradle to the grave are working poor Black women whose work participation rates belie their poverty rates. The proposed legislation will improve the economic futures for many women who have worked their entire lives in low-wage industries and occupations.

We have recommended additional reforms to private employer-provided pension plans that will assure greater participation by low-wage workers. If implemented, these reforms could provide coverage for the most severely disadvantaged segment of our working society -- those individuals whose employment has kept them at or below poverty throughout their entire work lives. We urge you to consider seriously these recommendations.

If we can provide further information, please contact us.

Yours truly,
Charlotte Rutherford

Charlotte Rutherford, Esq.
Director
Black Women's Employment Program

Legal Defense Fund

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WRITTEN TESTIMONY OF THE NAACP LEGAL DEFENSE AND EDUCATIONAL FUND, INC. BLACK WOMEN'S EMPLOYMENT PROGRAM

ON

S. 1784--THE RETIREMENT INCOME POLICY ACT

SUBMITTED TO THE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
SENATE COMMITTEE ON FINANCE

FEBRUARY 10,1986

Charlotte B. Rutherford
Terisa E. Chaw
Black Women's Employment Program

Contributions are deductible for U.S. income tax purposes

The NAACP LEGAL DEFENSE & EDUCATIONAL FUND is not part of the National Association for the Advancement of Colored People although it was founded by it and shares its commitment to equal rights. LDF has had for over 25 years a separate Board, program, staff, office and budget.

SUMMARY OF TESTIMONY

FACTS

1. The availability of private employer-provided pension plans traditionally has been tied to the better-paying industries and occupations in the nation's workforce.
2. Black women are disproportionately underrepresented in those better-paying industries and occupations and therefore, few Black women have been able to participate in private employer-provided pension plans.
3. Over half of all Black female heads of households earn wages that are at or below the poverty level.
4. 80 percent of elderly Black women who live alone are in poverty.
5. Only 22 percent of all Black women 55 years and older had ever received income from any type of employer-provided pension plan, whether public or private, in 1982.
6. Only five percent of all elderly Black women received income from a private employer pension plan in 1984.
7. 30 percent of single elderly Black women depend entirely upon Social Security benefits for their income and nearly 90 percent depend upon Social Security benefits for half of their income. The average annual Social Security benefit received by elderly Black women was $2,304.

RECOMMENDATIONS

1. Private employer-provided pension coverage should be available to all workers, especially those who work in low-wage occupations.
2. Private employer-provided pension coverage should be available to part-time workers with 500 or more annual work hours.
3. Private employer-provided pension coverage should be available to new employees who are 65 years old or who are within five years of retirement age when they enter that workforce.
4. Vesting requirements should be no more than five years for all private pension plans, including multiemployer plans, and they should apply to part-time workers who are employed 500 hours or more annually.
5. The practice of integrating social security and pension benefits should be eliminated. The Act should establish a required minimum pension benefit amount to be paid to retirees.
6. Portable pensions that vest after one year should be made available to that segment of the workforce whose jobs are often subject to intermittent lay-offs, unemployment, part-time employment and high mobility.

The NAACP Legal Defense and Educational Fund, Inc. (LDF) is a non-profit corporation organized to assist Black American citizens in securing their constitutional and civil rights. In April 1984, the Board of Directors of LDF approved for implementation the Black Women's Employment Program, a new project designed to address problems encountered by working poor Black women. The Black Women's Employment Program was developed in response to our long-standing concern about a growing permanent underclass that is disproportionately comprised of Black Americans, and about the increasing number of working Black single mothers and their children who are living in poverty. Since its inception, the Black Women's Employment Program has engaged in a variety of activities to improve the economic conditions of working poor Black women.

Although women as a group have made a number of gains in pension coverage, participation and benefit entitlement in recent years, much of which can be attributed to the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 and the Retirement Equity Act of 1984, further congressional action is required in order to achieve pension equity among all workers and to ensure adequate retirement income to the nation's workforce. LDF commends this Committee's efforts to redress some of the more serious inequities and inadequacies in the private pension system through Senate Bill 1784--the Retirement Income Policy Act of 1985 (the "Act").

LDF supports the policy goals of the Act to the extent that such policy goals increase worker coverage in private employer provided pension plans; encourage growth and development of pension plans among all private employers, especially those who own small businesses; and assure adequate retirement income to the nation's retired workforce. However, the Act has both strengths and weaknesses as indicated by the testimony presented to this Committee on January 28, 1986 by Anne E. Moss of the Pension Rights Center, and Dr. Mary W. Gray of the Women's Equity Action League (WEAL). We refer this Committee to that testimony.

This written testimony will focus on how the most fundamental provisions of the Act--pension coverage, vesting, portability and integration--affects working poor Black women who will become a part of this country's retired workforce. Our testimony includes an overview of the precarious socio-economic status of working poor Black women so that the importance of pension benefits to these women is fully understood and appreciated. The jobs which Black women hold during their working years have a direct correlation to the kind and amount of retirement benefits they may receive, if any, on retirement. We also include recommendations that we believe will further redress the inequities that currently exist in this nation's private pension policy.

An Overview of Working Poor Black Women

1984, the poverty rate for Black Americans was 34 percent compared to 12 percent rate for White Americans.[1/] This means that one of every three, or 9.5 million, Black Americans were living in poverty in 1984.[2] The number of Blacks in poverty increased by nearly 2 million between 1978 and 1984.[3] Families that are headed by a single woman are more than three times as likely to be poor than families headed by a married couple or a single man.[4] However, families that are headed by a single Black woman are more than five times as likely to be poor.[5] In 1984, 53 percent of all families headed by single Black women lived in poverty,[6] even though the majority of these women were in the labor force. Approximately 63 percent of single Black women with children under 18 years of age were in the labor force, as were 70 percent of those with children between the ages of 6 and 17, and 57 percent of those with children under the age of six.[7]

The fact that many working Black women are poor can be attributed largely to inequities in their earnings, job status and job benefits--including those economic benefits provided by private employer pension plans. For instance, Black women who work full-time year round are paid approximately 56 cents for every dollar paid to White men.[8] The earnings of almost 53 percent of Black women heads of households are at or below the poverty level.[9] More than 70 percent of all Black women are employed in low-wage and low-status occupations--30 percent are employed in private household and service occupations (i.e., cleaning services, teacher aids, social worker aids and health service aids), while 30 percent work in low skill clerical jobs (i.e., file clerks, clerical assistants, typists, telephone operators and receptionists), 7 percent in nondurable goods as operatives, and 3 percent as retail sales workers.[10] As they reach what is romantically described as their "golden years" in life, many of these women will become a part of the elderly Black population who are now living in poverty.

Elderly Black Americans comprise more than 8 percent of all persons 65 years old and over in this country.[11] Approximately three out of every five (60.2 percent) elderly Blacks are women.[12] Elderly Black women who live alone or with nonrelatives comprise one of the nation's poorest groups.[13] In 1982, 80 percent of all elderly Black women living alone lived in poverty while only 49 percent of White women and 34 percent of White men were poor.[14] Throughout their lifetimes Black women continue to earn approximately half as much as White men. In 1982, the median annual income for single elderly Black women was $3,710 compared to $5,920 for White women, $4,660 for Black men, and $7,750 for White men.[15] The disparity was even greater between single elderly Black women and elderly married couples as elderly married Blacks and Whites had median annual incomes of $8,790 and $15,690, respectively.[16] The latest data available from the Social Security Administration reveals that the average annual Social Security benefit received by elderly Black women is $2,304 compared to $3,120 received by elderly White women.[17]

The Social Security benefits received by single elderly Black women are woefully inadequate to enable them to maintain a standard of living above poverty subsistence when such benefits are either their sole or primary source of support. Thirty percent of single elderly Black women depend on Social Security benefits for their entire income and 86 percent depend on such benefits for half or more of their income. 18/ These facts clearly indicate that other sources of retirement income are required if an overwhelming majority of elderly Black women are to live out their remaining years in independence and dignity and not in abject poverty.

Many studies have concluded that certain job characteristics--the individual's occupation, length of employment service, and annual earnings--are the most important factors that determine whether or not an individual will be covered or recieve benefits under a private employer pension plan.19/ All of the studies indicate that Black workers are much less likely than White workers to possess those job characteristics that lead to a high probability of pension coverage: employment in manufacturing, or as a professional or technical worker; long employment service; and annual earnings of $15,00 or more. These studies show that Black workers tend to be employed more often than Whites in nonprofessional service occupations where private pension coverage plans are not common, they tend to have fewer years of employment service which prevents them from meeting vesting requirements even when an employer does provide a pension plan, and they tend to have lower annual earnings.20/ As more fully discussed below, Black women are particularly disadvantaged with respect to pension benefits provided by private employers since an overwhelming number work in nonprofessional occupations, have intermittent periods of employment service, and earn low- wages.

Only five percent of all elderly Black women (married and nonmarried) received income from a private employer pension plan in 1984, compared to 12 percent of all White women, 20 percent of all Black men, and 34 percent of all White men who were 65 years old and over.21/ The mean annual private pension income of elderly Black women was $1,641 compared to $2,478 for White women, $3,067 for Black men, and $4,624 for White men.22/ In 1982, only 22 percent of all Black women 55 years old and over had ever received income from any type of employer provided pension plan, whether public or private, compared to about 30 percent of Black men, 45 percent of White women and 50 percent of White men.23/ Obviously, Black women's receipt of benefits from pension plans is greatly disproportionate to their labor force participation.

In order to ensure that all workers have adequate income in their retirement, they must be afforded equal access to and participation in private employer pension plans. To achieve full pension equity among all workers, private employer pension plans must be provided by small employers as well as large employers, and pension coverage must extend to low-wage earners as well as to high-wage earners, part-time workers as well as full-time workers, and older workers as well as younger workers. In addition, vesting requirements must be made available to accommodate the intermittent work patterns of many Black women. The practice of integrating Social Security benefits and pension benefits should be abolished, however, short of this, the integration of such benefits should at least provide a minimum pension benefit amount that enables retirees to maintain a decent standard of living.

Pension Coverage

As recognized by the Act, nearly half of all workers in this country are not covered by any type of pension plan. The Act attempts to increase coverage by requiring all those employers who provide a pension plan for employees in a single line of business to include in a plan those employees who have earnings that are below the Social Security taxable wage base ($42,000). LDF supports this provision because it would eliminate the practice of excluding low-wage earners and workers in typically low-coverage occupations from participation in private pension plans. Although this provision would offer pension coverage to many low-wage Black women, the provision falls short of its policy goal of assuring adequate retirement income to all of the nation's workforce. The provision should extend coverage requirements to part-time workers who are employed at least 500 hours annually and to older workers.

Coverage for Low-Income

As previously discussed, many studies have shown that individuals who are employed in high-status and high-earning occupations in the private sector are much more likely to be covered by pensions and receive pension benefits than those individuals who work in low-status and low-wage jobs. For example, private pension coverage is highest in such high-wage industries as communications and public utilities where coverage is 82 percent, mining (69 percent), and manufacturing of durable goods (68 percent) and nondurable goods (61 percent).24/ Black women's employment in these high-wage industries, however, is quite low, and in some of these industries, many Black women are paid below poverty wages. For instance, only 3.7 percent of all Black women are employed in communications and public utilities (over 25 percent earn below poverty wages); only .12 percent are employed in mining; and 7 percent in nondurable goods manufacturing.25/

Black women are overrepresented in their employment in low-wage industries that typically do not provide pension coverage. Pension coverage is provided to 70 percent of workers who earn $15,000 or more yearly but coverage for workers who earn less than $10,000 in low-paid, high mobility service, labor and sales jobs ranges from 25 to 43 percent.26/ Annual full-time income for Black women service workers in 1982 was $8,204 and for clericals $11,348.27/ Sixty percent of all Black women workers are employed in clerical and service occupations.28/ The median annual income for full-time Black women workers was $11,161 compared to $21,036 for White men.29/ The expanded coverage proposed by the Act will benefit many Black women who earn low wages and who work in low-coverage occupations.

Part-time Workers

The disproportionate overrepresentation of Black women in part-time or intermittent employment in low-paying occupations greatly contributes to poverty among Black women. An average of 18 percent of all workers are employed part-time.30/ But in the occupational categories heavily occupied by Black women, part-time employment is much higher.31/ Fifty percent of all Black women work part-time, part-year, and the vast majority do so involuntarily.32/ The largest proportions of involuntary part-time workers may be found in the service occupations, among operators classified as handlers, and among retail sales workers.33/ Low-wage industries such as private households and personal services exhibit the highest involuntary part-time employment rates and tend to employ disproportionately large numbers of Black women.34/

Part-time employment is rarely accompanied by such non-wage benefits as pensions and health insurance. In addition, many part-time jobs pay lower hourly wages than full-time employment even when the work is essentially equal.35/ The median annual income of Black women who work part-time in low-wage occupations is $2,775.36/ It is $3,213 for Black women who work part-time year round, and $6,179 for those who work full-time in such occupations.37/

Some employers may offer part-time employment as an incentive for women who desire to work part-time and to spend more time with their families. Other employers may offer part-time employment so that they can avoid the increasing costs of seniority, advancement opportunities and employer provided non-wage benefits that accure to full-time workers.38/

In order to ensure adequate retirement income for the great number of Black women who are employed part-time throughout their working lives, the Act must include a provison to require employers to offer pension benefits to those who work over 500 hours annually.

Older Workers

Many older Black women continue working or re-enter the labor force in their later years. Black women between the ages of 55 and 64 comprised 21 percent of all Black women employed as private household workers and 32 percent of all Black women employed as service workers in 1982.39/ Even after age 65 Black women's representation in household and service employment remains high: 41 percent of all Black women employed as private household workers were 65 and older; and 28 percent of all Black women employed as service workers were 65 and older.40/ Almost half of all elderly Black women have incomes below the poverty level.41/

Nearly 31 percent of all Black families are headed by a woman who is 55 or older.42/ Families that are headed by older Black women are twice as likely to have children under 18 years of age than older White female headed families.43/ Older Black women have a higher probability than White women of being displaced homemakers either due to the death of their spouse or to divorce, and many of these women enter or re-enter the workforce in their later years in order to support themselves and their families.44/ These women are typically too young for Social Secuirty and sometimes too old to participate in private employer pension plans. The Act's pension coverage provision must be extended to prohibit private employers from excluding from coverage individuals who start employment at 65 years of age or who begin their employment within five years of the plan's retirement age.

Vesting of Pension Benefits

The Act proposes to reduce requirements for the vesting of pension benefits from ten to five years in all private employer provided pension plans, with the exception of those provided by multiemployers. LDF supports the proposed reduced vesting requirements because few Black women are ever able to meet the current ten year requirment due to the high rates of part-time employment, unemployment and high mobility that are associated with the jobs that most Black women occupy. However, we strongly believe that the five year vesting requirement should apply to pension plans provided by multiemployers and to part-time workers who work 500 hours or more annually so that full pension equity among all workers is achieved. Workers should not be penalized because they work part-time or because they work for an employer who is a part of a multiemployer pension plan. We thus recommend that this Committee consider extending this reduced vesting requirement to apply to multiemployer pension plans and to part-time workers who are employed more than 500 hours annually.

Portability of Pensions

The provisions in the Act governing the portability of vested pensions must be extended to address the important needs of many Black women who have intermittent work histories. Intermittent employment patterns may reflect personal choices but among Black women, it is much more likely to be caused by the fluctuating nature of the occupation or industry in which they are is employed. As a result, many Black women never acquire enough tenure in their job for their pension benefits to vest and any benefits that may have accrued are forfeited when separation from employment occurs.

LDF recommends that private employers be required to provide pension benefits to all workers, including those who work part-time and in low-wage occupations, and that vesting requirements of no more than one year be established for those industries that are subject to intermittent employment patterns.

Truly portable pensions would allow workers to have any employer pension contributions that they have accrued among their various employers placed in an individual retirement account so that they can provide adequately for themselves upon retirement. These suggested changes to the proposed Act would greatly improve the economic status of many Black women and in the future serve to prevent disproportionate numbers of older and elderly retired Black women workers from living in poverty.

Integration

Under current law, the system of integration of Social Security and pension benefits has often eliminated pension contributions or benefits for lower paid workers while benefitting higher paid workers. The Act proposes to eliminate this patently unfair result by requiring employers to provide the vested retiree with at least 50 percent of the contribution or benefit amount that would have been paid without integration. Although this is an improvement over existing law, LDF believes integration should be entirely eliminated. At the very least, however, the Act should establish a required minimum pension benefit amount to be paid to retirees that would ensure an adequate retirement income--particularly for those with long histories of inadequate wages.

Also, integration formulae should be simplified and employers should be required to explain the effects of their particular formula to their employees. LDF recommends that this Committee more fully study the whole issue of integration and how specific integration formulae affect different workers at various income levels. Any formula that is adopted ought to be related to the average earnings of workers as a whole and be designed to improve the retirement earnings of all workers rather than focusing only on replacing the high wages of higher paid workers at the expense of lower paid workers.

NOTES

1. Smaller Slices of the Pie: The Growing Economic Vulnerability of Poor and Moderate Income Americans (November 1985) at 8, Center on Budget and Policy Priorities, Washington, D.C.

2. Ibid.

3. Ibid.

4. Ibid.

5. Ibid.

6. Ibid.

7. "Black Women in the Labor Force," Facts on U.S. Working Women, Fact Sheet No. 85-6 (July 1985) at 2, U.S. Department of Labor, Women's Bureau.

8. "Women of Color and Pay Equity," (undated) at 2, National Committee on Pay Equity, Washington, D.C.

9. Ibid. at 3.

10. J. Malveaux, Low-Wage Black Women: Occupational Descriptions, Strategies for Change (January 1984) at 12, unpublished manuscript, study commissioned by the NAACP Legal Defense and Educational Fund, Inc.

11. "A Profile of Elderly Black Americans," (February 1985) at 3, National Caucus and Center on Black Aged, Inc., Washington, D.C. We use the term "elderly" in this testimony to describe those persons who are 65 years old and over.

12. Ibid.

13. Ibid. at 5.

14. Income of the Population 55 and Over, 1982, SSA Publication No. 13-11871 (March 1984) Table 4, U.S. Department of Health and Human Services, Social Security Administration.

15. Ibid. at Table 14.

16. Ibid.

17. "Social Security and Minority Women," WEAL Facts (June 1983), Women's Equity Action League, Washington, D.C.

18. Ibid.

19. See, Black-White Differences in Private Pensions: Findings

from the Retirement History Study, HEW Publication No. (SSA) 79-11700 (February 1979), U.S. Department of Health, Education and Welfare, Social Security Administration; Patterns of Worker Coverage by Private Pension Plans (1980), U.S. Department of Labor, Labor-Management Services Administration, Pension and Welfare Benefit Programs; Findings from the Survey of Private Pension Benefit Amounts (1985), U.S. Department of Labor, Office of Pension and Welfare Benefit Programs; "Women, Families and Pensions," Issue Brief (December 1985) No. 49, Employee Benefit Research Institute, Washington, D.C.

20. Black-White Differences in Private Pensions at 16-18.

21. U.S. Bureau of the Census (1984), unpublished data.

22. Ibid.

23. Income of the Population 55 and Over, 1982 at Table 4.

24. Patterns of Worker Coverage by Private Pension Plans at 3.

25. J. Malveaux at 12.

26. Patterns of Worker Coverage by Private Pension Plans at 4.

27. U.S. Department of Labor, Bureau of Labor Statistics (1982), unpublished data.

28. J. Malveaux at 12.

29. U.S. Department of Labor, Bureau of Labor Statistics (1982), unpublished data.

30. J. Malveaux at 21.

31. B. Woody and M. Malson, Uncertainty and Risk in Low-Income Black Working Women (February 1984) at 67, unpublished manuscript, study commissioned by the NAACP Legal Defense and Educational Fund, Inc.

32. Ibid.

33. J. Malveaux at 22.

34. B. Woody and M. Malson at 69.

35. Ibid. at 64.

36. Ibid. at 65.

37. Ibid.

38. Ibid. at 69.

39. J. Malveaux at 83-84. The term "older" is used in this testimony to describe those persons between 55 and 64 years of age.

40. Ibid.

41. Ibid. at 35.

42. Dolores Davis-Wong,"Employment, Problems, Challenges, and Opportunities for Middle-Aged and Older Women" (July 1981) at 6, National Caucus and Center on Black Aged, Inc.

43. Ibid.

44. Ibid.

RETIREMENT INCOME POLICY COMMITTEE

LOUISVILLE EMPLOYEE BENEFIT COUNCIL

Introduction

This society has long recognized the need to assist its members in meeting the challenge of preparation for their retirement years. Prior to 1920, senior citizens had to depend on their families and their savings to sustain them through retirement. In the early 1920's, however, labor and management groups separately developed private pension plans which were subsequently extended favored tax treatment by Congress. Finally, as part of the New Deal, Franklin Roosevelt introduced the Social Security System which became the third leg of the so-called "three legged stool" supporting retirement security.

Within the last 10 years, each of the three legs of the stool has been substantially strengthened. Personal savings has been enhanced through the introduction of Individual Retirement Accounts (IRAs), Social Security has been funded at higher levels, and in 1974 private pensions were overhauled by ERISA.

Although ERISA and its progeny have corrected many abuses, recent legislation including TEFRA, DEFRA and REA, has significantly increased the complexity of administering private pension plans and further has reduced the tax incentives of maintaining them. Piecemeal legislation enacted over a short time span has dramatically reduced the attractiveness of these plans and indeed threatens the existence of the private pension system itself.

To assume that our society can thrive without private pensions given the status of the other two legs of the stool is patently absurd. Although IRAs have increased dramatically in aggregate assets, the majority of those who use them are middle and upper middle income members of society. Even maximum accumulations in IRAs will not be sufficient to support the account owners in retirement. Likewise, Social Security is doing well to hold the line at its present level with a shrinking worker base expected to provide prospective funding. Accordingly, the preservation of the private pension system is vital to the retirement income policy of the United States.

Given the importance of the private pension system, the Louisville Employee Benefit Council proposes herein to set forth a statement for consideration by Congress in the development of a national retirement income policy. This statement will set forth the LEBC's understanding of the basic principles of retirement income policy, review the current legal environment, examine recent legislative proposals, and offer recommendations for new legislation.

Retirement Income Policy

Retirement income is simply income received during the retirement years from a source other than current employment. As discussed above, this income typically comes from three sources, personal savings and earnings thereon, Social Security, and private pensions. In order to remove the burden of having society provide more than Social Security, taxpayers are encouraged to provide private pensions through favorable tax treatment accorded to contributions and benefits under qualified pension plans. The LEBC believes that, with the exception of cost of living adjustments, tax incentives should not be accorded to development of benefits which exceed the participant's income during the time he or she was actively employed. On the other hand, such incentives should encourage the accumulation of benefits high enough to put the participant over the poverty level during his or her retirement years. In other words, the establishment of limitations on contributions, tax deductions and benefits should be coordinated with the appropriate income level in mind.

Plan design should be encouraged which provides for basic retirement income in the form of a monthly income at the time of retirement, death or disability and possibly in the case of extreme financial hardship prior to retirement. Ancillary benefits such as loans and in-service withdrawals should be severely limited to hardship cases. Early coverage, vesting and portability of benefits should be expanded to insure fairness to an increasingly mobile work force.

Likewise, maintenance of plans must be encouraged through simplification and uniformity in plan administration rules. The use of multiple discrimination tests and excessive reporting and disclosure requirements unduly burdens plan administration and provides virtually no benefit to the participants. Multiple legislative changes must provide ample time for the plan sponsor to conform its documents, to understand new legislative requirements and to adjust its administration of its plans to comply with new requirements. This lead time can be accomplished through prospective effective dates and limitations on the number of compliance changes to be required within a specific period of years.

To the extent possible, pension rules should conform to the rules for other qualified employee benefit programs. Consistency between welfare benefit plans and pension benefit plans in the areas of discrimination rules, reporting and disclosure, eligibility and coverage would simplify the administration of both types of plans.

In short, the LEBC agrees with the statement contained in the Heinz-Clay bill. National Retirement Income Policy must be developed within the focus of its own goals and not within the focus of ancillary goals such as the production of tax revenues or capital formation for investment. We must have a coherent retirement income policy to guide tax and pension law changes toward the goal of enhancing retirement security, to develop consistency in legislation affecting retirement plans, to simplify rules of administering retirement plans, and to reduce disruptive effects of legislation on plan sponsorship and administration.

What follows is an examination of the primary areas of pension law which impact on retirement income security. These areas will be reviewed in the context of current law, proposed changes and LEBC suggestions for implementing the above statement of policy.

IMPACT OF COMPLIANCE REQUIREMENTS ON QUALIFIED PLANS

The Retirement Income Policy Act (RIPA) has as one of its stated purposes to "encourage employer sponsored plans to deliver better retirement benefits to more workers". The Act also expresses concern with the trends in pension coverage which grew rapidly in the 1950's and '60's, has remained relatively stable since the early 1970's and actually declined in the early 1980's. One cannot help but notice the correlation between the trend in pension coverage and the timing of major pension legislation; little or nothing in the 1950's and 60's, then ERISA in 1974, then ERTA, TEFRA, DEFRA and REA in 1981, 82 and 84, respectively.

In 1986 even more major legislative action is being considered. The increasingly cumbersome compliance requirements and constant legislative action have had a disruptive effect on plan sponsorship and administration.

PRESENT LAW

Currently, an employer who wants to establish a plan must overcome a number of obstacles and deterrents.

First, it must determine what type of plan it needs and can afford. Secondly, to establish a plan properly, it must be concerned with a number of documents; the Plan itself, Trust Agreement, Summary Plan Description, Applications for Participation, Beneficiary Designations, Corporate Resolution, Notice to Interested Parties, Annual PBGC Premium Payment, and IRS Determination Letter application with 5302 Census Data, Schedule T, and usually Power of Attorney forms.

In addition to documentation, properly establishing a plan requires compliance with various timing deadlines for establishing the plan, filing the Summary Plan Description with the Department of Labor, furnishing plan participants with Applications for Participation, Summary Plan Descriptions, and Notice to Interested Parties, filing the Determination Letter Request with the IRS, and funding the plan.

Once the plan is in place, the employer must comply with other rules that govern ongoing administration of a plan. These include rules concerning how much it can contribute, deadlines for making contributions, prudent investments, participant loans, 5500 Series annual reports, Summary Annual Reports, Disclosures to plan participants, Allocations of contributions, earnings and forfeitures, PBGC Reports, Notices concerning Spousal Consent and election rules for Joint and Survivor Annuities, Qualified Preretirement Survivor Annuities, Procedure and Notice requirements concerning Qualified Domestic Relations Orders, written explanations of rollover rules, Federal Income Tax withholding rules, participant election forms and spousal consent rules with respect to lump sum distributions. The plan sponsor should also maintain records concerning items the IRS and DOL included on their checklists of information requested during audits. If the recent trend in legislation continues, the law will change again within a year or two reducing the tax savings the sponsor receives from maintaining its plan(s), requiring a plan amendment process which will trigger the need for going through most of the steps necessary to establish a plan, and expanding the complexity associated with the ongoing administration of a plan.

It is no mystery that plan coverage is declining, especially for small firms who employ 3/4 of the 47 million employees not covered by plans. They cannot easily afford the cost of developing or purchasing the expertise that is needed to keep a plan in compliance.

RETIREMENT INCOME POLICY ACT

RIPA would attempt to overcome some of the problems which have discouraged small employers from offering pensions in the past by allowing employers who adopt a SEP to have the tax and cost advantages of a 401(k) plan. RIPA would also reduce both the cost and the complexity of plan administration in several areas.

By requiring that benefits for employees who depart prior to age 59-1/2 either be retained in the plan or transferred directly to an IRA, RIPA would promote the actual uses of cash accumulations for retirement purposes and eliminate the need for many of the notice, election and consent requirements for preretirement distributions and reduce the volume and complexity of 1099R tax reporting. By repealing capital gains and 10 year forward averaging rules, RIPA would reduce the tracking and record keeping that must be done currently for proper reporting of lump sum distributions, and would simplify the decisions a participant must make concerning the method of distribution at retirement as well. RIPA would also simplify some calculations by its proposed repeal of the combined limit on Defined Benefit and Defined Contribution plans.

In some respects, RIPA would have a negative impact on compliance and administration. First, it would require detailed changes to virtually every retirement plan, although the impact of these changes is mitigated by the Act's postponement of effective dates to no sooner than two years following enactment, and if no plan amendments are adopted, to as late as December 31, 1991.

Secondly, RIPA's new .5% minimum benefit or 3% retirement contribution before an employer can maintain a "non-retirement savings plan," represents a questionable change in the minimum benefit rule which would necessarily add complexity to compliance and administration.

Finally, the proposal in RIPA to reduce an employee's IRA limit by the amount of his 401(k) deferrals could lead to an increase in tracking and reporting requirements. Such a provision would also discourage individual savings for retirement, undermining the policy goals articulated in Section 2(c)(3) and (10) of the Act.

TAX REFORM ACT

Like RIPA, the proposed Tax Reform Act ("TRA") would require amendment of virtually all plans and so would have a negative impact on plan sponsorship and administrative compliance. However, unlike RIPA, the provisions of TRA would not have a deferred effective date. The earliest possible amendment deadline would be 1-1-88, but the plan amendments would apply retroactively to the effective date of the new law and the plan would have to be operated in accordance with the new law during the interim period.

Also, TRA, like RIPA, would reduce an individual's IRA limit by the amount of his 401(k) or 403(b) deferrals. As outlined above, such provisions would increase reporting requirements, and discourage personal savings.

Thirdly, TRA would complicate compliance for cash or deferred arrangements (CODA's). For example, under present law where two or more CODA's are maintained by the same employer, the deferral percentages for any employee participating in both plans are added together for purposes of the 401(k)(3) ADP tests. TRA would complicate this by only combining such deferral percentages for highly compensated employees and by changing "highly compensated employee" from a 24-word single concept definition to a 3-pronged definition that requires eight sub-paragraphs of explanation.

Even more complicated are the changes TRA would make to non-discrimination requirements. Not only would the Act retain and tighten the three ADP tests in Section 401(k)(3), it would also add 11 paragraphs and 17 subparagraphs of additional non-discrimination provisions in a new subsection 401(m) for employer matching contributions and employee contributions. In explaining the reasons for the proposed change, the committee expressed concern that present law on matching contributions encourages employees to shift a greater share of the cost of retirement savings to employees. The committee is also concerned that present law relating to employee contributions favors the highly compensated and they want to better insure comparable participation by rank-and-file employees. If the provisions of this new subsection accomplish these goals, they do so in a complex way, which discourages the use of 401(k) plans in the aggregate and therefore can be expected to reduce the availability of these plans and benefits for rank-and-file employees.

TRA would simplify lump sum distribution rules by repealing capital gains treatment. Additionally, TRA would simplify a participant's decision between special averaging and rollover of lump sum distributions because the benefits of forward averaging would be cut from 10 years down to 5 years.

There would be a 5-year phase out period in capital gains treatment for individuals who are age 50 and over, and during that period some calculations would be slightly more complex than they are now.

LEBC COMMENTS

RIPA takes positive steps towards simplified compliance rules. It articulates a comprehensive retirement income policy to guide tax and pension law toward the goals of enhancing retirement security, simplifying and unifying pension rules and reducing the disruptive effect of legislation on plan sponsorship and administration.

TRA is not a comprehensive program. It further complicates compliance and plan administration, and in this respect, resembles the piece-meal legislation that has been enacted over the last few years. Accordingly, the LEBC recommends that any additional legislation in the pension area follow the lead of RIPA toward consolidation of pension rules into a simple, coherent format which will enhance rather than deter plan formation and maintenance.

COVERAGE AND DISCRIMINATION RULES

CURRENT LAW

In order to insure the availability of plan participation to a broader class of employees, ERISA established minimum participation and coverage requirements for most classes of employees except certain union employees and aliens.

The minimum participation standards of ERISA and the Code help to assure individual rights of eligible class employees to prompt and timely participation in a qualified plan maintained by their employers. Plans may satisfy the law if they meet either of the two percentage tests found in Section 410(b)(1)(A) of the Code, the nondiscriminatory classification test found in Section 410(b)(1)(B) of the Code, or if they satisfy either test in conjunction with another plan maintained by the employer or the controlled group of which the employer is a member. These tests have been part of the law for over ten years now and are generally understood by plan administrators.

Among qualified plans only Section 401(k) and tax credit ESOP plans have their own non-discrimination rules. Tax credit ESOPs need only cover 50% of the eligible employees of the employer as long as the allocations to the accounts of participants do not exceed 2% of each participant's compensation for the year. Section 401(k) plans must meet the requirements of Section 410 in addition to the benefit discrimination rules of Section 401(k).

TAX REFORM ACT

TRA does not address coverage and discrimination issues generally but does address the discrimination rules of Section 401(k), apparently in an effort to make it more difficult for highly compensated employees to make significantly higher contributions to these plans for themselves than for other employees. The definition of highly compensated employee is rewritten along the lines of the key employee definition contained in Section 416 but is not the same and is complex in the extreme. Eligibility standards are limited to one year of service and attainment of age 21. Contribution differentials between highly compensated employees and other employees are narrowed based on new, more complex simultaneous equations. The non-discrimination rules proposed for matching contributions are extensive, highly complex and beyond the frustration threshold of most plan administrators. In short, these provisions clearly discourage the use of Section 401(k) plans and they do not constitute a simplification of the rules nor do they promote broader coverage of pension plans.

RETIREMENT INCOME POLICY ACT

The RIPA represents a bold move to further achieve an original goal of ERISA, being to expand the coverage of plans by requiring pension plans to extend eligibility to all employees in the sponsoring employer's "relevant work force". If the work force is divided into two or more allowable subdivisions, the plan must meet an 80% coverage test and each employee in each subdivision who is under (earns less than) the social security contribution and benefit base is eligible to participate in a retirement plan of the employer. The requirement can be met by combining plans. If any retirement plan requires mandatory contributions, at least 60% of the eligible employees must actually participate. The definition of "relevant work force" follows the old exclusions permitted in Section 410 of the Code. Finally, the three year eligibility alternative is eliminated for all plans.

RIPA also addresses the discrimination in qualified plans permitted through integration of contributions (defined contribution plans) and benefits (defined benefit plans) formulas with social security. Contributions and benefits determined on the portion of salary below the wage base must be at least equal to 50% of the respective contributions or benefits on the portion of salary above the wage base.

RIPA clarifies but does not substantively change the discrimination tests in Section 401(k) of the Code.

LEBC COMMENTS

The LEBC believes that the broad approach of RIPA in extending coverage of plans to a more extensive segment of the population as a prerequisite for the establishment of cash accumulation plans is clearly an appropriate step toward the original goals of ERISA. The LEBC would suggest consideration of substituting a 100% coverage test for all classes of employees in retirement type plans excluding those who have not met the age and service requirements and those in collective bargaining and certain alien groups. There is no apparent rationale for not going all the way with retirement type plans. Even with cash accumulation plans, all employees except for the excluded classes should be able to participate even if they ultimately elect not to do so. A uniform rule such as the new 60% rule articulated in RIPA could be applied to all cash accumulation plans, including Section 401(k) plans. A simple, singular rule would promote the addition of plans and the expansion of coverage under such plans.

The proposal relating to integrated plans contained in RIPA should be expanded to consider the impact of integrating a plan which has a 401(k) provision or which is maintained by the employer with a separate 401(k) plan. Plan integration, when combined with the effects of permitted 401(k) differences in contribution percentages, can seriously erode contribution levels for rank and file employees where 401(k) plans are integrated with social security or where 401(k) plans are combined with other retirement plans. Integration of plans with social security should also require that the wage base used for integration purposes be the actual wage base which applies in a particular year. Such a rule would minimize the impact of integration on rank and file benefits.

CONTRIBUTION AND BENEFIT LIMITATIONS FOR INDIVIDUALS AND CORPORATIONS

ERISA established a comprehensive structure of limitations on contributions, benefits and tax rules relating to each. A brief review of those rules is presented below to establish a context for examining the new TRA and RIPA provisions on each area.

CURRENT LAW

1. The limits on benefits for an individual in a defined benefit plan are as follows:

The maximum annual benefit an individual may receive under a defined benefit plan, payable in the form of a straight life annuity (or a qualified joint and survivor annuity), is the lesser of -

(a) $90,000, or

(b) 100% of the participant's average compensation for the highest three (3) years.

The above benefit must be reduced if the participant has less than 10 years of service with the employer, or if benefit payments commence prior to the attainment of age 62 (but not reduced below $75,000 for benefits commencing after age 55).

2. The limits on annual additions for an individual in a defined contribution plan are as follows:

The annual addition credited to an individual under a defined contribution plan may not exceed the lesser of -

(a) $30,000, or

(b) 25% of the participant's compensation.

The annual addition is the sum of the following -

(a) employer contributions,

(b) forfeitures, and

(c) the lesser of:

  (i) employee contributions in excess of 6% of compensation, or

  (ii) one-half of the employee contributions.

3. With regard to cost of living adjustments, the $90,000 figure in item (1) above and the $30,000 figure in item (2) are to be adjusted annually for increases in the cost of living under procedures similar to those used in adjusting primary insurance amounts under the Social Security Act. However, no such cost of living adjustment shall be made before January 1, 1988.

4. Section 415(e) of the Code provides a very complex method for limiting benefits and annual additions of an individual who is or has been a participant in both a defined benefit plan and a defined contribution plan maintained by the same employer. This computation essentially limits the individual to receiving the full limit (as stated above) from one plan, and 25% (40% for lower-paid individuals) of the limit in the other plan. Section 416 of the Code reduces the 25% limit to 0% for a top-heavy plan.

5. In addition to the limitations placed on benefits and annual additions accruing to the benefit of any individual in a qualified retirement plan, the Code places restrictions on the amount of employer contributions which may be deducted on the employer's tax return. These restrictions tend to further limit the annual

additions for an individual in a profit sharing or stock bonus plan. The primary restrictions are as follows:

(a) Generally, an employer may not deduct a contribution to a profit sharing or stock bonus plan which exceeds 15% of the compensation of covered employees. However, if less than 15% of covered compensation is contributed in any year, the excess of the 15% limit over the actual contribution may be carried forward to a later year, and the employer may contribute such amount, provided that the total contribution for that year (the carry-forward amount plus the current year contribution) does not exceed 25% of the compensation of covered employees.

(b) Generally, an employer may not deduct total contributions to a combination of plans, one of which is a profit sharing or stock bonus plan, which exceeds 25% of the compensation of covered employees.

If, in any year, an employer contributes an amount to a qualified retirement plan which may not be deducted in that year, such amount may be carried over and deducted in succeeding years subject to the deduction limits for those years.

6. Section 401(k) plans are subject to special anti-discrimination rules, in addition to the same benefit and contribution limitation rules covering other profit sharing plans.

7. A plan, other than a top-heavy plan, may determine benefits and contributions based on an individual's total earnings from the employer. The compensation used to determine benefits and

contributions for an individual in a top-heavy plan is limited to $200,000; such amount to be adjusted for cost of living increases as described in item (3) above.

TAX REFORM ACT

1. The following changes are proposed in the benefit limits for an individual in a defined benefit plan under TRA:

(a) The $90,000 limit discussed in paragraph 1 is changed to $77,000.

(b) The reduction in the benefit for less than 10 years of service is changed to a reduction for less than 10 years of plan participation.

(c) The $75,000 limit discussed in paragraph 1 is changed to $65,000.

2. Defined contribution plan limits under TRA would be the following:

(a) The $30,000 limit discussed in paragraph 2 is changed to $25,000.

(b) Item (c) in the definition of annual addition is changed to include all employee contributions.

3. TRA also proposes the following change in the cost of living adjustments:

The adjustments to the defined benefit dollar limitation ($77,000) would remain as under current law, but adjustments to the defined contribution dollar limitation ($25,000) would not commence until the defined benfit limit, as adjusted, equals four times the defined contribution limit. From that point on, the four-to-one ratio would be maintained.

4. Limits on benefits and annual additions for an individual participating in both a defined benefit plan and defined contribution plan would be changed under TRA as follows:

Although no change is made to the current law provisions of Section 415(e) of the Code, a new provision would be added which establishes a 15%, employee-paid excise tax on any distributions (during a calendar year) to an individual from qualified retirement plans (including IRAs) which exceed the greater of -

(a) $112,500, or

(b) 125% of the defined benefit dollar limitation.

5. The following changes are proposed under TRA in the tax-deductibility of employer contributions:

(a) The carryforward provisions for a profit sharing or stock bonus plan would be eliminated.

(b) The 25% of covered compensation limit placed on deductions for employer contributions to a combination of plans which includes a profit sharing or stock bonus plan would be extended to any combination of plans which includes both a defined benefit plan and a defined contribution plan.

(c) A new provision would be added which offsets the deduction for employer contributions permitted for a defined contribution plan by the amount of OASDI contributions taken into account in the allocation of contributions under the plan.

(d) A new provision would be added which places a 10%, employer-paid excise tax on any amounts contributed to the plan by the employer that are not currently deductible.

6. The following special limitations are added by TRA on Section 401(k) (cash or deferred) plans:

(a) Elective contributions to 401(k) plans and 403(b) annuities for an individual would be limited to $7,000 for any one year.

(b) Elective contributions to 401(k) plans and 403(b) annuities for an individual would be used as a direct offset to the amount the individual could otherwise contribute to an IRA.

(c) A new provision would be added which places a 10%, employer-paid excise tax on excess contributions to a 401(k) which are not returned to the employer within 2-1/2 months following the end of the plan year.

7. The following change is proposed in the definition of compensation used in determining benefits and contributions:

The annual compensation taken into account under the plan would be limited to seven times the defined contribution dollar limitation (i.e., initially, 7 X $25,000, or $175,000).

RETIREMENT INCOME POLICY ACT

1. RIPA revises limits on benefits for an individual in a defined benefit plan by changing the $90,000 maximum benefit limit to an amount equal to 200% of the Social Security Taxable Wage Base in effect at the beginning of the plan year.

2. Limits on annual additions under RIPA for an individual in a defined contribution plan would be as follows:

- (a) The $30,000 figure would be changed to 50% of the Social Security Taxable Wage Base in effect at the beginning of the Plan Year.
- (b) The 25% of compensation limitation would be changed to 20% of compensation.
- (c) A limitation would be added with respect to annual additions to a non-retirement savings plan, equal to the lesser of:
  - (1) 25% of the Social Security Taxable Wage Base in effect at the beginning of the plan year, or
  - (2) 10% of the participant's compensation.
- (d) Item (c) of the definition of annual addition would be changed to include one-half of employee contributions (i.e., the 6% of compensation provision would be eliminated).

3. Cost of living adjustments under RIPA would be automatically invoked by the changes proposed under items (1) and (2) above, which tie the limitations to the Social Security Taxable Wage Base.

4. The following change is proposed in the limits on benefits and annual additions for an individual participating in both a defined benefit plan and defined contribution plan:

Section 415(e) would be repealed under RIPA except in the case where at least one of the plans involved is a top-heavy plan.

5. RIPA also establishes special limitations on Section 401(k) (cash or deferred) plans as follows::

(a) A new provision would be added which places a special limitation on an individual's annual addition to a 401(k) plan equal to 25% of the Social Security Taxable Wage Base in effect at the beginning of the plan year.

(b) Elective contributions to 401(k) plans for an individual would be used as a direct offset to the amount the individual could otherwise contribute to an IRA.

6. A provision would be added which limits an individual's annual compensation used for determining benefits and contributions under a plan to 500% of the Social Security Taxable Wage Base in effect at the beginning of the plan year.

LEBC COMMENTS

1. Reducing the limits on benefits which may be provided in a defined benefit plan or a defined contribution plan may save revenue but does not serve to expand pension coverage. When limits are reduced, employers tend to put fewer dollars into qualified plans for rank-and-file employees as well as for the highly compensated ones. If RIPA were true to its charter, it would not change these limits at all.

2. Committee reports relating to TRA indicate the desire to have the defined benefit dollar limitation to be four times the defined contribution limitation. However, TRA would reduce these limitations, maintaining a ratio of less than 4 to 1, and provide for a freeze in cost of living adjustments to the defined

contribution limit until the 4 to 1 ratio is achieved. RIPA would adjust immediately to the 4 to 1 ratio.

By tying all limitations to the Social Security Taxable Wage Base, RIPA provides a simple, understandable basis for the limitations and cost of living adjustments. However, if the Social Security Wage Base is legislatively increased beyond normal cost of living increases, another standard may well become necessary.

3. TRA provides a simple alternative to the current limitation placed on benefits and contributions under a combination of plans by placing a 15% excise tax on excessive benefit payments; however, TRA does not repeal the current complex limitations of Code Section 415(e). In addition, TRA provides further restrictions by limiting the deduction for employer contributions to a combination of plans, including a defined benefit plan and a defined contribution plan.

RIPA repeals the current limitations under Section 415(e), except for combinations of plans including a top-heavy plan, and provides for no real replacement to those limits except for the reduction to the individual plan benefit and annual addition limitations. It seems that by adopting the restrictions contained in TRA for combinations of plans, the current provisions of Section 415(e) could be eliminated, even for a combination including a top-heavy plan, thereby achieving the desired limitation in a simple manner.

4. TRA makes significant changes in the area of the deductibility of employer contributions. The repeal of the carryforward provisions for deductibility of profit sharing and stock bonus plan

contributions appears counter-productive, assuming it is still the intent of Congress to encourage employers to provide profit sharing retirement benefits for employees. This particularly affects employees of employers in cyclical industries where an employer may reduce or make no profit sharing contribution for a plan year because of the level of profits, but would want to "make-up" this lost contribution in profitable years. The result will be lower accumulations for all employees and especially the rank-and-file.

The extension of the 25% of compensation limit on deductions to a combination of plans has the effect of limiting benefits and contributions to individuals covered by these plans similar to current limits for combinations including a top-heavy plan. As mentioned above, this change may be desirable if made in conjunction with the repeal of the current law limits on individual benefits and annual additions for an individual under a combination of plans including top-heavy plans.

The 10% excise tax on excess contributions introduced by TRA appears harsh when one considers that: (a) the employer does not take a current deduction for such amounts; (b) it is not at all unusual for an employer to make an excess contribution due to reasonable error; and (c) the Internal Revenue Service and Pension Benefit Guaranty Corporation have historically discouraged any refund of plan contributions to the employer. TRA provides a 2-1/2 month period to return excess contributions under a 401(k) plan but does not appear to allow this grace period for other employer contributions. It is suggested that this provision be removed or a grace period for the return of excess contributions be added.

5. Although the LEBC believes that no change in 401(k) plan rules is desirable, the framework contained in RIPA for non-retirement savings plans provides a positive influence for employers to establish and maintain 401(k) plans in addition to retirement plans, even with the strict limitations on annual additions. TRA provides no such positive influence but rather substantially increases the complexity of administering and utilizing such plans and as stated elsewhere herein, could possibly have the effect of destroying the practical usefulness of 401(k) plans altogether.

6. The changes proposed under RIPA and TRA for defining compensation to be used in determining benefits and contributions tend to bring all plans under the rules contained in current law requirements for a top-heavy plan and, therefore, obviate the need for a top-heavy category of plan.

DISTRIBUTIONS AND WITHDRAWALS, TIMING AND TAXATION

1. Minimum Distribution Rules

A. Present Law

(1) Before Death Distribution Rules. To be qualified, a plan must provide that the entire interest of each participant will be distributed no later than the participant's required benefit commencement date. Alternatively, the participant's entire interest must be distributed in substantially non-increasing annual payments over (i) the life of the participant, (ii) the lives of the participant and the designated beneficiary, (iii) a period not extending beyond the life expectancy of the participant, or (iv) a period not extending beyond the life expectancies of the participant and a designated beneficiary.

The participant's required benefit commencement date is generally April 1 of the calendar year following the calendar year in which the participant retires or the participant attains age 70-1/2, whichever is later. If the participant is a 5% owner in the plan year ending in the calendar year in which the participant becomes 70-1/2, then the distributions are required to commence by April 1 of the calendar year following the calendar year in which the participant attained age 70-1/2 even though the participant has not retired.

In addition to these rules, the "incidental benefit rule" generally requires a plan to provide for a form of distribution under which the present value of the payments projected to be made to the participant, while living, is more than 50% of the present value of the total payments projected to be made to the participant and the participant's beneficiaries. However, a distribution pattern is not prohibited by the incidental benefit rule to the extent that the distribution is required by the rules relating to qualified joint and survivor annuities.

(2) After Death Distribution Rules. With respect to the rules governing distributions after the death of a participant, the applicable rule depends upon whether benefits commence before or after the participant's death.

If the distribution of benefits commenced to the participant before death, the remaining portion of the participant's interest is to be distributed at least as rapidly as under the method of distribution in effect prior to death. Where benefits did not commence prior to the death of the participant, the entire benefit must be distributed within the next five years, unless one of the following exceptions apply:

> (a) Benefits are payable to a designated beneficiary over the life of the designated beneficiary or over a period not extending beyond the life expectancy of the beneficiary so long as those distributions commence no later than one year after the date of death and the distributions are paid under rules that meet the minimum distribution requirements for before-death distributions.
>
> (b) Benefits are payable to the participant's surviving spouse, over the life of the spouse or over the life expectancy of the spouse, and payments commence no later than the date on which the participant would have attained age 70-1/2.

(3) Tax Sheltered Annuities and Custodial Accounts. Present law provides post-death minimum distribution rules similar to the rules for qualified plans.

(4) IRAs. Present law provides before and after death minimum distribution rules for IRAs corresponding to the rules applicable to qualified plans. Distributions from an IRA, however, are required to commence no later than April 1 of the calendar year following the calendar year in which the owner of the IRA attains age 70-1/2.

B. Tax Reform Act

(1) Uniform Commencement Date. Under TRA, distributions under all qualified defined benefit and defined contribution plans, individual retirement accounts, and tax sheltered custodial accounts and annuities must commence no later than April 1 of the calendar year following the calendar year in which the participant attains age 70-1/2, without regard to the actual date of retirement.

(2) Excise Tax on Failure to Make a Minimum Required Distribution. A 50% nondeductible excise tax on the excess amount that should have been distributed over the amount that actually was distributed will be imposed on any individual required to take such distribution. No change is made to the current rules regarding minimum distributions and the incidental benefit rule. The amount which would have to be distributed in any given taxable year is to be determined under regulations to be issued by the Treasury.

According to the House Ways and Means Committee Report, if the participant selects a permissible distribution option, the minimum required distribution in any year is the amount required to be distributed in that year under the payout option selected. If the participant selects an impermissible payout option, the minimum required distribution is intended to be an amount that would have been distributable to the participant had the participant selected a joint and survivor annuity payable over the life expectancies of the participant and the beneficiary (if any) actually designated by the participant, taking into account their actual ages. According to the Committee Report, it is intended that the excise tax will apply even if the distribution method is in accordance with the plan and the plan has received a favorable determination letter.

C. Retirement Income Policy Act

RIPA generally requires that distributions commence from retirement plans by the end of the plan year in which the employee attains age 70-1/2 or retires, whichever is later. An exception to this rule would require owner employees to begin taking distributions at age 70-1/2 without regard to the owner employee's date of retirement. This bill also generally requires periodic distributions (and not lump sum distributions) for benefit payouts beginning prior to age 59-1/2. See 2.C., below. No other changes in current law regarding minimum distributions are made by RIPA.

D. LEBC Comments

The lack of uniformity in the distribution rules applicable to tax-favored plans creates significant disparities in opportunities for tax deferral among individuals covered by different types of plans. The LEBC supports uniform rules which would eliminate such disparities and would reduce the complexity of the existing rules.

Specifically, the LEBC supports the TRA rule requiring the commencement of distributions from all tax-favored plans (qualified retirement plans, IRAs, and tax sheltered annuities and custodial accounts) by April 1 of the calendar year following the calendar year in which the participant attains age 70-1/2, without regard to the actual date of retirement. This change would remove the disparities which now exist among various types of retirement vehicles, and would eliminate the need to determine a participant's actual date of retirement, a sometimes subjective determination.

The LEBC also supports the TRA rules which apply uniform minimum distribution rules to all tax-favored retirement arrangements. These rules ensure that such retirement arrangements accomplish the purpose for which they are intended--replacement of a participant's preretirement income stream rather than an indefinite deferral of tax on a participant's accumulation under a plan. The LEBC believes, however, that the minimum distribution rules are, at least in part, a codification of the "incidental benefit rule" and the statute or regulations should clarify that the incidental benefit rule would not continue to apply after the applicable effective date.

The LEBC also supports the application of a non-deductible excise tax on the individual for failing to take the required minimum distribution. The LEBC believes that an excise tax on the individual is preferable to the disqualification of the plan since disqualification may adversely affect other plan participants who may have no connection or control over the failure to make minimum distributions. The LEBC recommends that the statute, or at least the regulations, clarify that the exclusive sanction for failure to make minimum distributions is the excise tax.

2. Early Distributions From Qualified Retirement Plans

A. Present Law

(1) Withdrawal Restrictions. Under present law, benefits may be distributed to a participant in a qualified pension plan only on account of plan termination or the employee's separation from service, disability, or death. Withdrawals while a participant is still employed are not permitted under a qualified pension plan before normal retirement age.

Withdrawals under qualified profit sharing or stock bonus plans are subject to fewer restrictions than those under qualified pension plans. Qualified profit sharing or stock bonus plans generally may permit the withdrawal of employer contributions after the expiration of a stated period of time (e.g., two years or longer) or after the occurrence of a stated event (e.g., hardship).

Special restrictions apply to benefits under a qualified cash or deferred arrangement ("CODA"). Generally, a CODA may not permit a participant to withdraw elective deferrals (or earnings on such deferrals) before the participant dies, becomes disabled, separates from service, attains age 59-1/2 or encounters hardship. Under proposed regulations, an employee is treated as having incurred a hardship only to the extent that the employee has an immediate and heavy financial need and does not have any other resources reasonably available to satisfy the need. Present law does not permit distributions under a CODA on account of plan termination.

Amounts invested in tax sheltered annuities are not subject to any withdrawal restrictions. However, withdrawals under a tax sheltered annuity program invested in a custodial account of a mutual fund may not be made prior to the time the account owner attains age 59-1/2, dies, becomes disabled, separates from service, or encounters financial hardship.

(2) Penalties for Early Withdrawals. A penalty tax is imposed on withdrawals from an IRA before the owner attains age 59-1/2, dies, or becomes disabled. A 10% penalty tax also applies to any withdrawals from qualified plans by or on behalf of 5% owners who have not yet attained age 59-1/2, died, or become disabled.

B. Tax Reform Act

(1) Withdrawal Restrictions. Under TRA, a CODA may make distributions on account of the plan's termination (provided no successor plan is established), as well as on account of the employee's death, disability, separation from service, or attainment of age 59-1/2. A distribution on account of the termination of a CODA must consist of the participant's total account balance under the plan. Distributions on account of hardship are permitted only to the extent of an employee's elected deferrals (income on those deferrals may not be distributed on account of hardship). Present law standards governing what constitutes a "hardship" continue to apply.

Under the bill, early distributions from a tax sheltered annuity or custodial account are prohibited unless the withdrawal is made on account of death, disability, separation from service or attainment of age 59-1/2. Withdrawals on account of hardship from a tax sheltered annuity or custodial account are permitted only to the extent that the contributions are made pursuant to a salary reduction agreement. The present law standards defining "hardship" for purposes of a qualified cash or deferred arrangement will apply to Section 403(b) annuities.

(2) Penalties for Early Withdrawals. Under the TRA, the 10% early withdrawal penalty imposed on IRAs is increased to 15% and is extended to early withdrawals from any qualified retirement plan, tax sheltered annuity or custodial account, or an individual retirement arrangement.

The tax will not be imposed on any distribution that is part of a scheduled series of substantially equal periodic payments (made not less frequently than annually) for the life of the participant (or the joint lives of the participant and the participant's beneficiary).

The Ways and Means Committee Report explaining the bill indicates that in the case of a defined contribution plan or IRA, the exemption from the tax is to be available only if the plan or IRA purchases a commercial annuity to fund the individual's benefit. The committee report also indicates that with respect to a defined benefit pension plan, a series of payments will not fail to be substantially equal solely because the payments vary on account of (i) certain costs of living adjustments, (ii) casn refunds of employee contributions upon an employee's death, (iii) a benefit increase provided to retired employees, (iv) an adjustment due to the death of the employee's beneficiary, or (v) the cessation of a Social Security supplement.

C. Retirement Income Policy Act

(1) Withdrawal Restrictions. This bill establishes uniform rules for distributions from retirement plans. A retirement plan may only distribute a participant's accrued benefit after the participant separates from service on or after attainment of age 59-1/2, or upon the death or disability of the participant.

An exception to the rule which prohibits distribution of benefits prior to age 59-1/2, death or disability permits the distribution of benefits if they are provided in a "retirement income form." "Retirement income form" is one of three kinds of distributions: (i) an annuity for the life of the participant, (ii) a qualified joint and survivor annuity, or (iii) a level distribution over life expectancy. These payments can be periodically adjusted for the payment of supplemental benefits prior to the receipt of Social Security benefits so long as these supplemental benefits do not exceed the amount of anticipated Social Security Benefits.

If the participant ceases his employment with the employer, the participant's account balance or accrued benefits can be transferred directly to an IRA, individual retirement annuity or other retirement plan without violating the aforementioned rules.

(2) Penalties for Early Withdrawals. Under RIPA, the premature distribution penalty imposed on IRAs is increased to 20%.

D. LEBC Comments

The LEBC supports the general concept contained in both RIPA and TRA that early withdrawals from tax-favored retirement arrangements should be discouraged. Present law imposes some withdrawal restrictions and sanctions, but such restrictions and sanctions are not uniformly applied and in many cases are not sufficient to discourage withdrawals. On the other hand, further withdrawal restrictions and sanctions should not be so severe that individuals are discouraged from saving for retirement because they fear an unanticipated financial emergency. The LEBC agrees with the TRA approach that withdrawals should be permitted only for financial emergency and that only employee contributions should be subject to withdrawal. The LEBC believes that the definition of "hardship" should be codified and should be restricted to those circumstances which constitute a financial emergency.

The LEBC also agrees with the application of uniform early withdrawal penalties on all tax-favored retirement arrangements. The LEBC recognizes that tax incentives for retirement savings are inappropriate unless the savings generally are not devoted to non-retirement uses. Since the current 10% penalty tax may not be a sufficient deterrent to the use of retirement funds for non-retirement purposes because the sanctions may be neutralized by the tax-free compounding of interest after five or six years, the LEBC agrees with the TRA proposal to increase the tax for early withdrawal from 10% to 15%. The LEBC also agrees with both RIPA and the TRA concept of excluding from the early withdrawal restrictions and sanctions payments which commence before age 59-1/2 in the form of substantially equal installments. The LEBC believes that the rules should not prevent employees from electing early retirement prior to age 59-1/2.

Finally, the LEBC supports the TRA change which permits distributions from CODAs upon plan termination.

3. Taxation of Distributions

A. Present Law

Generally, a distribution of benefits from a tax-favored retirement arrangement is includable in gross income. In the case of a distribution from a qualified plan or an IRA, such distribution is includable in the year in which it is paid or distributed. Under a tax sheltered annuity, benefits are includable in income when paid or made available.

Under present law, a lump sum distribution from a qualified plan may qualify for special 10-year forward income averaging. In addition, the portion of a lump sum attributable to contributions prior to January 1, 1974, may qualify for capital gains treatment.

Special tax rules apply when an individual receives a distribution of employee contributions from a tax-favored retirement arrangement. If an amount is received before the annuity starting date, the individual is considered to have received non-taxable employee contributions first and taxable employer contributions and earnings second.

Amounts received by an employee after the annuity starting date are generally treated, in part, as a return of the employee's contributions and, in part, as taxable income. The portion of each payment treated as a return of employee contributions is that amount which bears the same ratio to each payment as the employee's total contributions bear to his total expected payments over the period of the annuity. In the case of a straight life annuity, the employee's life expectancy, as of his annuity starting date, is treated as the period over which the annuity is to be paid for purposes of computing his total expected return under the contract. Where the employee dies prior to the expiration of his anticipated life expectancy, no deduction is provided for the employee's unrecovered basis. However, where the employee lives longer than anticipated at the time his benefits commence, the employee is able to exclude from income an amount in excess of the employee's total contributions.

A special rule applies under certain circumstances to annuity payments from qualified plans. Under this rule, if an individual's first three years of annuity payments after the annuity starting date will equal or exceed the individual's aggregate employee contributions, all distributions are treated as a return of employee contributions (and thus non-taxable) until all the individual's employee contributions have been recovered. Thereafter, all distributions are fully taxable.

B. Tax Reform Act

Under the bill, an owner of a tax sheltered annuity is subject to tax only when benefits are actually received.

The bill repeals 10-year forward income averaging and phases out pre-1974 capital gains treatment over a six year period. The bill permits individuals to make a one time election to use 5-year forward averaging (calculated in the same manner as 10-year averaging under present law) for a lump sum distribution received by an individual after age 59-1/2. It also permits certain individuals to apply 5-year averaging to one lump sum distribution received before age 59-1/2 if they have attained age 50 by January 1, 1986.

Amounts received prior to the annuity starting date are treated as being made first out of taxable amounts (employer contributions and earnings) and second as being made out of non-taxable amounts (employee contributions).

With respect to amounts received after the annuity starting date, the special three year basis recovery rule is eliminated. Thus, an employee must include in income a portion of each payment made on or after the employee's annuity starting date.

In computing the portion of each payment that may be excluded from income, the employee's expected total return is to be determined as of the date of the payment. The bill limits the total amount that an employee may exclude from income to the total amount of the employee's contribution. Additionally, if the employee's benefits cease prior to the date the employee's total contributions have been recovered, the amount of unrecovered contributions is allowed as a deduction to the annuitant for his last taxable year.

C. Retirement Income Policy Act

RIPA repeals 10-year forward income averaging and capital gains treatment of lump sum distributions. It does not address any changes with respect to basis recovery or constructive receipt under a tax sheltered annuity.

D. LEBC Comments

The LEBC supports the TRA restriction which generally limits the availability of income averaging and capital gains treatment to those individuals who have attained age 59-1/2. Such restriction encourages the use of tax-favored plans for retirement purposes and is consistent with the policy of providing tax-favored treatment only for amounts used for retirement. However, the LEBC believes that on or after 59-1/2, an individual should be entitled to some flexibility in terms of how the individual's retirement benefits should be distributed. Personal circumstances may dictate that the individual's best choice with respect to at least a portion of his or her retirement savings is a lump sum distribution. The tax consequences should be a neutral factor in any decision regarding the manner in which retirement benefits are distributed. Therefore, the LEBC supports the retention of an income averaging or other tax method which will equate as much as reasonably possible the tax consequences of a lump sum distribution with periodic payments over the life of the individual and his designated beneficiary. Moreover, the LEBC believes that to provide uniformity and decrease complexity, such tax method should be available under all tax-favored retirement arrangements (IRAs, qualified retirement plans, and tax sheltered annuities and custodial accounts).

In order to further discourage early distributions or withdrawals, the LEBC supports the TRA change which provides that amounts received prior to the annuity starting date are treated as being made first out of taxable amounts (employer contributions and savings) and second as being made out of non-taxable amounts (employee contributions).

To reduce complexity and to further encourage the use of tax deferred amounts for retirement purposes, the LEBC supports the elimination of the special three-year basis recovery rule and the limitation of the amount that can be excluded from income to total employee contributions as proposed in TRA.

Finally, the LEBC supports the TRA change which provides that an owner of a tax-sheltered annuity is subject to tax only when benefits are actually received. This change corrects a needless disparity which exists under present law.

PARTICIPANT LOANS

CURRENT LAW

Loans from qualified plans have been restricted under ERISA to loans to participants unless an administrative exemption from the prohibited transactions provisions is obtained from the Department of Labor. In order to satisfy the requirements of ERISA, loans to participants have had only to be adequately secured, bear a reasonable rate of interest and be available to all plan participants on a non-discriminatory basis. TEFRA narrowed the amounts effective for plan loans by treating as a distribution any loan over the maximum limit of $50,000 or one-half of a participant's vested interest, whichever was less (or a participant's vested intrest for loans of $10,000 or less), and set a maximum term of five years unless the loan is for purchase or renovation of a primary residence. Loan rules for 401(k) plans are currently the same as for other types of qualified plans. The Department of Labor has been active in auditing plans with participant loans and has attacked many such loans for inadequate security or interest rate even though the Department has never issued clear-cut, specific guidelines regarding either interest rates or security.

TAX REFORM ACT

TRA further tightens the loan requirements by limiting maximum loans obtainable to $50,000 reduced by the highest loan balance from the plan during the year ending on the date before the date of the loan. In addition, level quarterly payments of principal and interest are required to pay off the loan. Finally, interest paid on loans made to key employees which are secured by their 401(k) or 403(b) account balances is treated as non-deductible employee contributions and no interest deduction will be permitted unless the loan is used to acquire a principal residence.

RETIREMENT INCOME POLICY ACT

RIPA seems to simply limit the application of loan rules under Section 72(p) to "retirement type" plans rather than cash accumulation plans. It is not clear whether the intent of this provision is to differentiate loans made from "nonretirement savings plans" or to actually prohibit all other loans. If the latter is the case that should be made clear, ERISA Section 408 and Section 4975 of the Code would also need to be amended.

LEBC COMMENTS

As the law moves toward a comprehensive national retirement income policy with parity among all types of plans and retention of plan assets in plans until a participant attains at least age 59-1/2, at which time benefits are ordinarily to be paid in the form of annuities, it becomes increasingly difficult to make a case for participant loans at all except in specific hardship situations (e.g., such as would warrant a hardship distribution under the 401(k) rules). Arguably, other resources such as plan withdrawals, have always existed and will continue to exist except for the truly hardship situation.

However, to the extent that any loans from qualified plans are deemed desirable, any new legislation should contain specific standards relating to the amount and type of security required (such as, at minimum, assignment of account balances); the minimum and maximum rates of interest required to be paid (with a safe harbor, such as the government index of prime rates); and the acceptable reasons for granting loans. Also desirable might be a prohibition against making loans to inactive participants and requiring that loan payments be withheld from salary checks. Finally, any new statute should make it clear tnat a default on a loan payment necessitates that the trustee issue a form 1099 reporting the defaulted amount as taxable income to the participant.

TOP HEAVY RULES

CURRENT LAW

TEFRA added Section 416 to the Code, which created a new set of restrictions that apply to "top heavy" plans. Under present law, a plan is top heavy if key employees are entitled to more than 60% of the total account balances (in a defined contribution plan) or more than 60% of the present value of cumulative accrued benefits (under a defined benefit plan). Neither RIPA nor TRA would change this. Under current law, top heavy plans are subject to additional requirements in the areas of (1) vesting, (2) maximum covered compensation, (3) minimum benefit/or contribution levels for non-key employees, and (4) reduced aggregate limits for defined benefit and defined contribution plans maintained by a single employer.

1. Vesting

IRC Section 416(b) currently requires a top heavy plan vesting schedule to be at least as fast as one of the following:

Years of Service	3-Year Vesting	6-Year Graded Vesting
1	0%	0%
2	0%	20%
3	100%	40%
4		60%
5		80%
6		100%

2. Maximum Amount of Covered Compensation

Under Section 416(d) of the Code, top heavy plans must currently limit the amount of an employee's compensation that may be taken into account in determining benefits or contributions to

$200,000. Annual cost of living adjustments to this limit are scheduled to begin in 1988.

3. Minimum Benefit/Contribution for Non-Key Employees

Under Section 416(c) of the Code, a top heavy defined benefit plan must currently provide a minimum benefit which is at least equal to the employee's average compensation for his high five years multiplied by the lesser of 2% times years of service, or 20%. Under a top heavy defined contribution plan, the minimum currently is the lesser of 3% of the participant's compensation, or a percent equal to the highest contribution rate for any key employee.

4. Reduced Aggregate Limits

As described previously, current law places restrictions on the overall limits with respect to employees who participate in both a defined contribution and a defined benefit plan, as described in Section 415(e) of the Code. A further reduction is required where the plan is top heavy. The reduction may be avoided, assuming no more than 90% of the benefits are for key employees, if the minimum benefit or minimum contribution for non-key employees is increased by at least one percent.

TAX REFORM ACT

TRA makes no major changes to current law provisions relating to top heavy plans. TRA, however, would impose certain top heavy-type limitations on all plans. First, TRA would limit maximum compensation used for the purposes of computing contributions and benefits to seven times the proposed dollar contribution limit for defined contribution plans (currently $25,000 X 7 = $175,000).

Second, as explained under "Contribution and Benefit Limitations," TRA also places an excise tax on excessive distributions from retirement plans.

Third, TRA limits employer deductions for contributions to a combination of defined benefit and defined contribution plans.

These limits on compensation, contributions and deductions provide an indirect means of imposing top heavy type limits in these areas on all plans.

RETIREMENT INCOME POLICY ACT

Likewise, RIPA makes no direct changes to the rules relating specifically to top heavy plans, but rather imposes top heavy type restrictions on all plans.

Specifically, RIPA:

(a) Establishes a maximum limitation on compensation used for the purposes of computing contributions and benefits of five times the Social Security Wage Base (currently 5 X $42,000 = $210,000);

(b) Requires 100% vesting after five years of service;

(c) Imposes minimum benefit limitations (.5%) and minimum contribution requirements (3% of compensation) on at least one retirement plan maintained by the employer; and

(d) Requires, as discussed under "Coverage and Discrimination Rules", minimum benefits for plans integrated with Social Security.

LEBC COMMENTS

The LEBC believes that the top heavy rules contained in TEFRA inappropriately discriminate against the plans of smaller employers with the result of actually reducing benefits for rank-and-file employees in many cases. The concepts contained in TRA and RIPA, if coordinated, would establish an evenhanded application of top heavy concepts to all plans without the administrative costs inherent in the complex procedures required under the Section 416 top heavy rules. Because TRA and RIPA address the concerns that Congress had when enacting TEFRA, and because these concerns are approached more fairly and simply under TRA and RIPA than in the top heavy rules, the LEBC strongly urges the repeal of Section 416 of the Code, and the enactment of those RIPA and TRA provisions described above.

PLAN TERMINATION ISSUES

1. Current Law. Under current law, excess assets in a defined benefit plan may not inure to the benefit of the sponsoring employer except upon termination of the plan and then only after satisfaction of all plan liabilities. The IRS further limits recovery of excess assets to only that portion of the excess which is attributable to actuarial error.

In the past several years, there has been an acceleration in the number of plan terminations wherein the principal motivation for the termination was the employer's desire to reach the excess assets. In some cases, no new plans were established; in others, successor defined contribution plans were established. In still other cases, the employer established an identical defined benefit plan which merely offset the value of the benefits accrued and distributed under the terminated plan (a Plan Termination/Re-establishment). Under another strategem, the employer would spin-off a portion of its existing plan as a separate plan to which all assets and liabilities attributable to retirees and vested terminated employees would be transferred (the "Plan Spin-Off"). All excess assets of the original plan would be transferred to the retiree/deferred vested participant plan whereupon that plan would be terminated, contracts purchased to provide the benefits to the former participants and the excess assets recovered.

Serious legal questions developed as to whether the latter two types of plan terminations should be given recognition for purposes of plan qualification and recovery of excess assets. The three government agencies primarily charged with the responsibility for regulating employee pension plans (i.e., the IRS, DOL and PBGC) issued joint guidelines on the termination process which implicitly recognized the employer's right to recover excess assets under the Plan Spin-Off and the Plan Termination/Re-establishment methods.

In a straight plan termination case, it is argued that plan participants, even though provided with their accrued benefits under the plan, are substantially harmed because of their inability to accrue further retirement benefits. It is further contended that establishment of defined contribution successor plans do not put the participant back in his pre-plan termination position, first because the benefits under the defined contribution plan are not guaranteed and second because such plans cannot provide the same benefit replacement for older employees because of their shorter period remaining until retirement. In the Plan Spin-Off and Plan Termination/Re-establishment cases, the financial security necessary to ensure the provision of retirement benefits is purportedly threatened because excess assets that should be used as a cushion in the event of bad investment performance or adverse plan claims are siphoned off.

The rise in the number of plan terminations and asset reversions in the past several years is directly attributable to a number of factors, not the least of which has been the success of ERISA in encouraging adequate funding of defined benefit plans. It is also attributable to (a) employers adopting conservative funding methods for determining contributions, (b) extraordinary investment returns due to market conditions over the past five years, and (c) favorable actuarial experience on employee rollover and mortality. Since the law requires that plans be funded on a going concern as opposed to a termination basis, the employer is required to fund anticipated benefits as well as accrued benefits. Therefore, at the time of termination, plans frequently contain funds accumulated for benefits not yet accrued, which assets would constitute excess assets since only accrued benefits are actually distributed upon termination of the plan. On a plan termination basis, some plans develop huge excesses which became tempting sources of funds to cash-squeezed employers.

2. Tax Reform Act and Retirement Income Policy Act. Under the proposed Tax Reform Act, employers would be assessed a non-deductible 10% excise tax on the amount of assets recovered from a defined benefit plan terminated after December 31, 1985. The rationale for the proposed change is probably best explained in the President's Tax Proposals which became the basis of the proposed Tax Reform Act. Therein, the Administration contends that employers gain an unintended tax advantage by receiving tax-favored assets on plan terminations despite the fact that the recovered assets are includable in the employer's gross income. The report argues that the employer retains the benefit of the initial deduction and of the tax deferral on the plan's income. With respect to assets accumulated over a long period of time in tax-favored plans, the alleged value of the tax advantages are quite substantial. Such

tax-favored treatment is considered inappropriate where the plan assets are not used to provide retirement benefits to employees. The proposal is intended not as a penalty tax but a means to recapture a portion of the substantial tax advantages provided with respect to a terminated plan's assets when such assets are not used to provide retirement benefits under the plan.

3. LEBC Comments. The proposed change as explained by the President's Tax Proposal, fits in well with the general objective of permitting tax-favored treatment of only those plans that provide retirement benefits. Although the tax is allegedly not intended as a penalty, obviously, its application will be perceived as a penalty and will admittedly have the salutary effect of deterring plan terminations. It can be argued that this in turn will protect the funding of promised retirement benefits.

On the other hand, the proposal may have just the opposite effect. The additional tax will discourage the formation of defined benefit plans, or if established, discourage adequate funding. It must be recognized, that an employer establishes a defined benefit plan in order to provide a promised benefit at retirement and no more. The employer acts as a guarantor in case the plan's assets are insufficient to pay such benefits and it correspondingly should be entitled to any excess that should exist after liabilities are satisfied. The tax advantages achieved by employers are a small price to pay for the adequate funding of plans to meet promised retirement benefits. The retirement income policy should instead focus its intent on encouraging the formation of defined benefit plans, the continuance of such plans and the adequate funding of such plans.

Termination of plans to recover excess assets could be discouraged by permitting employers to recover assets in excess of some specified percentage (e.g., 150%) of the present value of accrued benefits computed on a termination basis without terminating the plan. The employer's ability to recover such excess should be limited to no more than once in any five year period. Permitting employers to recover excess assets on other than a termination basis has apparently been successful in other countries in satisfying the needs of employers while protecting the benefit expectations of employees. Permitting employers to recover excess assets on other than a termination basis in the manner described above, will better insure the continued accrual of benefits for the participant, will better recognize the legitimate needs of the employer, and will encourage the maintenance of plans most generally considered appropriate for providing retirement benefits. An appropriate alternative might be to provide that the 10% excise tax only applies in the event that the employer terminates the defined benefit plan to recover assets in excess of that described above.

WELFARE PLAN BENEFITS

1. Present Law

"Welfare plans" under ERISA encompass a broad spectrum of non-retirement-related employer-provided benefits, including but not limited to "medical, surgical or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services." (ERISA Section 3(10)(A)). There is (or at least is intended to be) a clear line between welfare plan benefits and retirement income benefits, and the most conspicuous limit upon what benefits a welfare plan may provide is that it may not provide pension benefits. On the other hand, the distinction between welfare plan benefits and what traditionally have been called employee "fringe benefits" is much fuzzier, although certain traditional fringe benefits such as on-premises recreation or dining facilities, holiday gifts, and sales to employees are not deemed welfare plan benefits. Even so, most of what loosely are being called "statutory fringe benefit plans" under Internal Revenue Code Section 79 (group life insurance), 105 and 106 (accident and health plans, 120 (qualified group legal services plans), 127 (educational assistance programs), and 129 (dependent care assistance programs) are actually employee welfare benefit plans, as are cafeteria plans under Code Section 125. Non-welfare-plan fringe benefits are presently covered under Section 132 of the Code.

Welfare plan benefits may be provided directly by the employer through insurance or self-funding, or, in certain instances, indirectly through a tax-exempt organization, such as a voluntary employees' beneficiary association (VEBA) to which an employer as well as employees may contribute. Interestingly, the discussion of "welfare benefit plans" under the Report of the Committee on Ways and Means on H.R. 3838 is limited to such benefits provided through VEBAs, group legal services funds, or supplemental employment benefit (SUB) funds.

Thus, the very term "welfare plan" may have a different meaning depending upon whether the discussion focuses upon current tax and revenue policy in particular, or more broadly upon ERISA and enforcement of the labor regulations and reporting and disclosure requirements. Beyond terminology, however, a more fundamental problem is that there are currently nearly as many distinct coverage and benefit rules for welfare plans as there are types of welfare plans. Nearly all welfare plans are subject to nondiscrimination rules of some sort, but there are often bewildering differences in the rules.

Although a full presentation of these current rules for all welfare plans would be unduly lengthy for purposes of this discussion, a few examples of disparate rules and results should suffice. One conspicuous problem is that the definition of the prohibited group varies among different types of welfare plans. E.g., under group-term life insurance plans, discrimination in favor of "key employees" (defined as under Code Section 416(i)) is prohibited, but self-insured health plans prohibit discrimination in favor of "highly compensated individuals" (specially defined in Code Section 105(h)(5), and potentially including some individuals who would not be defined as key employees). Code Section 505, setting forth anti-discrimination rules for welfare plans funded through VEBAs, prohibits discrimination in favor of "highly compensated individuals" and adopts the Section 105(h)(5) definition with one exception (i.e., the prohibited group includes the top 10% of participating employees rather than the top 25%). A single employer with all three types of welfare plans just discussed might well spend an inordinate amount of time, effort and expense simply identifying these different prohibited groups.

A related problem is consistency of administration under current law. An employer with one type of welfare plan may have no difficulty obtaining an IRS ruling as to its qualification, but in the case of another type of welfare plan the best an employer may be able to do is to make an application which does nothing more than avoid an initial unfavorable ruling but provides no protection against a later retroactive disqualification of the plan based upon subsequently articulated standards. An example of the latter problem would be a VEBA plan which provides for some element of employer funding of benefits. Small employers, who may be more susceptible and so more averse to the risk of plan disqualification than some larger employers, may particularly be discouraged from getting involved with certain types of welfare plans permitted under current law.

Another instance in which administration of the welfare benefit plan laws may have unintended and disparate results is in application of the rule common to many types of plans that a nondiscriminatory "class" of employees may be benefited, and other classes excluded, in lieu of the employer meeting one of the various objective percentage tests. Here again, larger employers are likely to be better able both to show a nondiscriminatory class of employees and to bear the legal and business expense of making such a showing. A frequently-used classification is salaried versus hourly employees. Non-discrimination may be shown by demonstrating that the prohibited group resides not exclusively in the favored class, or that the favored class represents a fair cross-section of the total workforce, or that the particular welfare benefit is appropriate or necessary to the occupation or duties of the class and not to other employees.

Finally, under current law the failure to meet nondiscrimination requirements has different results in different types of welfare benefit plans. In some instances, only the "excess" benefits provided to prohibited group members are deemed taxable to them as ordinary income; in other instances the prohibited group alone is taxed on all benefits received; and in yet others the benefits of all employees are deemed taxable and the plan is, in effect, wholly disqualified.

2. Tax Reform Act

The TRA generally would replace the various eligibility, coverage, and nondiscrimination requirements for welfare benefit plans under the previously-discussed Code provisions with the "comprehensive" nondiscrimination rules set forth in new Section 89 of the Code. They may be summarized as follows:

(1) A uniform eligibility rule for all "statutory fringe benefit plans," welfare benefit funds, and cafeteria plans -- at least 90 percent of all employees must be eligible to participate, and the plan must contain no eligibility provisions which would discriminate in favor of "highly compensated employees" (as defined in Code Section 401(k)(5)). Excluded employees for purposes of the 90 percent test are (at maximum) those with fewer than 180 days' service, those who normally work less than 20 hours per week, those who normally work less than 1,000 hours per year, and those below age 21. Mandatory and permissive aggregation rules are provided for multiple plans, and a "line of business" exception is provided to allow separate qualification under the rule for each separate line of business or operating unit of an employer.

(2) A separate nondiscriminatory benefits test is provided for "insurance-type plans" (i.e., employer-maintained plans that provide accident or health benefits, group-term life insurance benefits, and group legal benefits). Generally, insurance-type coverage must be the same for all employees covered by the plan (group-term life coverage may still be proportional to compensation), but a limited exception is provided to accommodate a reduction in the employer subsidy under accident or health plans for employees normally working less than 30 hours per week. Also, under accident or health plans fewer than 25% of employees benefiting may

be highly compensated employees, and at least 75% of employees eligible to participate must actually benefit. Employer-maintained health plans may be integrated with benefits provided under Medicare or other federal or state law (or other health plans of the employee or family members). For insurance plans other than accident or health plans, at least 75% of eligible employees must benefit (the 25%-highly-compensated test is omitted).

(3) A separate nondiscriminatory benefits test is provided for "other" statutory fringe benefit plans (whether or not actually funded by insurance): (a) benefits available to highly compensated employees must be available to other eligible employees on the same terms and conditions; and (b) the average benefit provided to these "other" employees must be at least 80% of the average benefit provided to highly compensated employees. Numerous rules are set forth for an objective determination of the "average benefit" in each case, including a special family member rule for certain prohibited-class employees.

For welfare benefit funds provided through VEBAs, the rules of Code Section 505 are repealed and requirements "similar" to those of new Section 89 are supplied, except that life insurance, disability, severance pay, or supplemental employment compensation benefits will not fail qualification merely because the available benefits bear a uniform relation to compensation. For cafeteria plans, the new Section 89 rules would supplement the present-law general non-discrimination test under Section 125(b)(1), but the present-law concentration test of Section 125(b)(2) is retained (i.e., statutory nontaxable benefits to key employees may not exceed 25% of such benefits for all employees).

As to taxability of discriminatory benefits, the bill generally provides that highly compensated employees are to be taxed only on the discriminatory "excess." The other employees are not to be disadvantaged by being part of a discriminatory plan, inasmuch as the discriminatory excess may be treated as a separate plan.

3. Retirement Income Policy Act

The Retirement Income Policy Act deals exclusively with pension plans and does not impact the rules relating to welfare plans.

4. LEBC Observations and Proposals

The LEBC acknowledges that the reduction in the variety and complexity of nondiscrimination rules for welfare benefit plans proposed in H.R. 3838 is a noteworthy step forward toward a more comprehensive and comprehensible government policy regarding these benefits. The uniform eligiblity standard and the single definition of highly compensated employees are much-needed changes.

However, H.R. 3838 leaves in place or creates a number of variations among plan standards and special rules whose rationale needs to be further articulated against the background of general government policy towards "welfare benefits." Once again, a problem that cannot be ignored is the divergence in terminology between the original broad concept of a "welfare plan" still contained in ERISA (and indeed already echoed in the broad definition of "welfare benefit fund" in Code Section 419(e)), and the narrower meaning of "welfare plan" implied in the 1986 Tax Reform Act, with the bulk of ERISA and Code Section 419(e) welfare plans falling in the new special category of "statutory fringe benefit plans." This use of the term "fringe benefit" is a distortion of the plain meaning of the phrase to most employees (and employers), since "fringe" most readily implies a benefit that is peripheral to a person's employment, highly desirable but not necessary, and something of an "extra" benefit. In the late 20th century, health and disability benefits have come to be regarded widely in the workforce as essential incidents of employment, not merely as "fringes". The ERISA term "welfare benefit" conveys the proper sense of how these benefits are regarded in society, and its use in the tax code as well in lieu of "statutory fringe benefits" would foster consistency and better understanding of the laws. The term "fringe benefits" should be reserved for non-welfare-plan fringe benefits such as those described in Code Section 132.

Additionally, an effort should be made to reconcile standards for welfare plans emerging from the Tax Reform Act with those proposed for retirement plans in RIPA. One praise-worthy development toward consistent treatment of all plans already apparent in TRA is a more uniform treatment of taxation of "excess" benefits to key or highly compensated employees in retirement plans and in welfare plans.

Except where differences in retirement income policy and welfare benefit policy are so profound as to require distinction, the objective standards in both types of plans should be the same. If rules can be unified and simplified so as to encourage greater welfare plan coverage (especially by smaller employers, many of whom currently do not offer such benefits to any extent), retirement income policy should be enhanced by the possibility of employee savings in health and other welfare-type costs being devoted to retirement planning.

STATEMENT ON THE RETIREMENT INCOME POLICY ACT OF 1985, S. 1784, SUBMITTED TO THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

Hearing Date: January 28, 1986

Submitted by:

Mutual of America
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February 11, 1986

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STATEMENT ON THE RETIREMENT INCOME POLICY ACT OF 1985, S. 1784

I am Dwight K. Bartlett, III, president of Mutual of America Life Insurance Company. Mutual of America is a tax-exempt, non-profit corporation whose primary business is underwriting employee benefit plans for non-profit health and welfare agencies. Mutual of America, which was previously known as National Health and Welfare Retirement Association, was founded in January 1945. The organization's founding fathers, who were primarily voluntary and professional leaders of the predecessors to United Ways and the organizations which they supported, sought to assure employee benefit programs for the staff members of their agencies.

Today, Mutual of America, which became our organization's name in 1984, is licensed in the District of Columbia and 48 states, with its home office in New York City and field offices in key cities throughout the country. At the end of 1985, Mutual of America was underwriting employee benefit plans covering approximately 282,369 employees who work for approximately 13,800 non-profit health and welfare organizations. Its policyholders are many of the nation's prominent publicly supported charitable organizations, including the United Way of America, United Ways in numerous communities, Girl Scouts of America, Goodwill Industries, Council of Jewish Federations, American Cancer Society, Association of Junior Leagues, and other hospital, philanthropic and charitable organizations.

Pension plans insured by Mutual of America include both defined benefit and defined contribution plans. Typically, the pension plans of Mutual of America's policyholders are small -- having 20 or fewer participants.

Mutual of America congratulates Senator Heinz for introducing this Bill and the Subcommittee for holding these hearings on the Retirement Income Policy Act ("RIPA"). The development of such a policy is long overdue. The accelerated adoption of piecemeal legislation, such as DEFRA, ERTA, REACT, and TEFRA, has created a volatile environment in the pension field which discourages adoption of employee benefit plans, makes their administration more and more expensive, and prevents their rational development in keeping with the needs and interests of employees, employers and our society as a whole. Where there needs to be predictability and stability, there is continued uncertainty; where there needs to be clarity and simplicity, there is increasing complexity. It is hoped that these hearings and the deliberations which follow will lead to the adoption of national policy based on a consensus about the role of retirement plans in the social and economic life of the nation.

Several of the priorities of RIPA are in keeping with those urged by Mutual of America, in previous statements to the Congress. Among these are emphasis on retirement over other savings plans; simpler and fairer integration and nondiscrimination rules; stricter limitations on early distributions; and incentives to small firms to offer retirement plans. Although it is troubled by some provisions or their implications, Mutual of America can support the Bill, in most respects.

In particular, we support RIPA's declaration of the following national retirement income policy goals:

- The current voluntary system of employer-sponsored retirement plans should be retained; and the growth and development of such plans should be encouraged;
- Employer-sponsored retirement plans should be sufficiently flexible to deliver adequate retirement benefits to workers with a variety of career patterns; and
- Benefits which are accumulated for retirement should be retained for that purpose.

Further, we generally favor RIPA's imposition of restrictions on distributions from retirement income plans, and we endorse the congressional finding that "current incentives for plan formation have been inadequate and special incentives are needed to encourage small businesses to establish employee pension benefit plans." Finally, we to agree that "[t]o the extent possible, retirement income should be provided from a variety of sources and should be sufficient to maintain an employee's preretirement standard of living throughout retirement."

However, two aspects of RIPA do cause concern to Mutual of American in behalf of its policyholders. The first relates to the implication of the legislation for Section 403(b) plans, although these plans are not explicitly addressed in the Bill, and the second is the proposed continuation of the "top-heavy" provisions.

SECTION 403(b) PLANS

While RIPA does not specifically address Section 403(b) plans, application of the Bill's provisions could be interpreted to mean that such plans could be continued only if contributions were made to "retirement plans," with the attendant withdrawal limitations, or to "nonretirement savings plans," but with after-tax dollars. Mutual of America strongly favors continuation of the current tax-deferred nature of contributions to Section 403(b) plans (i.e., with pre-tax dollars), with greater withdrawal flexibility than is available under a qualified pension plan.

Tax-deferred annuity plans under Section 403(b) were introduced because there can be no tax incentive for charitable employers to make contributions to retirement savings; therefore, the incentive was provided to the employee. These plans have served well the needs of employees of these organizations over many years.

Accordingly, employees of charitable organizations have a special interest in the tax incentives for retirement benefits. Employees, such as those of Mutual of America's policyholders, tend to be less well paid than their counterparts in the business sector. In 1982, employees of philanthropic organizations had an average income of $12,525, as compared to $16,797 for the civilian workforce as a whole. While the disparity may be lessening, albeit slowly, the effects of years of low compensation on planning for retirement continue to be felt by those employees who have worked for years in the charitable community, and are likely to be felt for some time in the future. With few exceptions, Mutual of America's policyholders simply cannot afford to offer the high-paying positions in which deferred compensation plans can make up for earlier low retirement savings, and in no event do charitable employers have such alternatives as stock options to compensate senior employees. For this same reason, these are not the plans likely to be of a kind from which arise perceptions of abuse.

Most of Mutual's policyholders maintain qualified pension plans for their employees. But, voluntary contribution programs are an important incentive used by Mutual of America's policyholders to encourage qualified applicants to accept lower paying jobs in the health and welfare sector and able employees to remain.

As Mutual of America testified in its April 1985 statement to the House Subcommittee on Labor-Management Relations: "Because Mutual of America's employers are not eligible for the deductibility of contributions to benefit plans on their own tax returns, the tax treatment of these benefits to the employees becomes more important that it is to tax-paying employers." Employees of charitable, non-profit organizations have little reason to expect their employers to match voluntary contributions. In these circumstances, Mutual of America believes that it is unnecessary to require that contributions under Section 403(b) be limited to retirement plans, particularly where, as under RIPA, there would be a requirement for a qualified pension plan, before a voluntary contribution plan could be maintained.

Moreover, to change the long-standing tax favored treatment of Section 403(b) plans in mid-stream would have a chilling effect on participation in such plans, particularly because withdrawal flexibility is a significant inducement for employees of charitable organizations to contribute to these plans and expectations have been built up over a long period.

Because Section 403(b) plans typically have penalties for withdrawal, participants are unlikely to make withdrawals except in cases of serious financial need. A recent study conducted by Mutual of America of Section 403(b) plans that it maintains indicates that 10,676 withdrawals were made by individuals prior to age 59-1/2 between January 1, 1984 and October 29, 1985. Compared to the total of 95,729 active Section 403(b) records, withdrawals during this 22-month period are equivalent to an annual withdrawal rate in the range of merely five to six percent. [1/] It should be noted that this relatively low rate of

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[1/] With respect to the analysis of early withdrawals, the following assumptions were made:

(a) Participants who are enrolled in Section 403(b) plans, but who have never made contributions, are not included in the total record count.

(b) Multiple withdrawals by one participant are not reflected. This system contains the date of the last withdrawal only.

(c) If a participant took a withdrawal prior to age 59-1/2 and took a subsequent withdrawal after age 59-1/2, the pre age 59-1/2 withdrawal is not reflected. This is because only the date of the last withdrawal is reflected in Mutual's records.

(Footnote Continued)

withdrawal has occurred during a time when personal savings are reported to be at record lows. The Washington Post, October 25, 1985, at A26.

Finally, the legislation should not impose consistency, for its own sake, in the tax treatment of all retirement plans. For the reasons discussed above, plans for employees of non-profit organizations justifiably deserve different tax treatment from plans for employees of profit organizations. Whatever the concerns for the recently developed 401(k) plan, were the Bill to impose a remedy for these concerns on 403(b) plans, it would be addressing problems that simply do not exist in a program with which there is much more experience than 401(k)'s. Because of the special significance of incentives for non-profit employees, the current tax-favored treatment of Section 403(b) plans should be preserved in this legislation.

TOP-HEAVY RULES

The proposed legislation would explicitly allow the application of "top heavy" rules to continue. "Top heavy" rules are administratively cumbersome and unduly complex. These rules were adopted in lieu of more direct measures across the board to make plans fairer and the payment of minimum benefits assured. They bear very heavily and inappropriately on relatively small not-for-profit charitable and welfare organizations, which

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(d) The total record count includes those participants who have made a total withdrawal from Mutual's Section 403(b) plans since January 1, 1984.

constitute a substantial percentage of Mutual of America's policyholders. Moreover, they discriminate unfairly by imposing special conditions on some plans and not on others, and often have the perverse effect of imposing administrative and other costs on small firms and organizations that can afford them the least. Thus, retention of the rules may well discourage the continuation of plans by small organizations.

Whatever the original limited justification for these rules, they would certainly have no basis were RIPA to be enacted. Simple, uniform nondiscrimination rules would assure that all tax favored plans provide broad nondiscrimination coverage; proposed social security integration rules would guarantee a minimum pension benefit to low income workers under all plans. The rules, with their negative consequences, should be removed from the Bill.

In the event that the top-heavy provisions are continued, it should be noted that RIPA, perhaps inadvertently, would increase the burden on small plans because it would reduce the defined contribution limit to $21,000. The definition of "key employee" for top-heavy purposes is now set at 1.5 times the defined contribution limit. The result of the reduction in RIPA would be to lower the key employee test from $45,000, under existing law, to $31,500. This result would increase the number of plans insured by Mutual of America that must be tested, for example, from 28% to 67%.

To eliminate this harsh outcome, Mutual of America proposes that in the regretable circumstance of continuing the top-heavy rules, that the key employee definition be set at the current definition of a "highly compensated" employee, *i.e.*, $50,000.

* * *

Senator Heinz is to be congratulated for the development of this proposed legislation to assure broad and more adequate pension coverage and to provide for greater simplicity and uniformity in administration. Mutual of America appreciates the opportunity to submit a statement and offers these comments to the Subcommittee as contributions toward those important purposes.

NRECA NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
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STATEMENT OF THE NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION RELATING TO HEARINGS ON S. 1784, THE RETIREMENT INCOME POLICY ACT OF 1985, BEFORE THE SENATE FINANCE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY

January 28, 1986

Mr. Chairman and members of the Subcommittee, I am Anthony C. Williams. I am the Director of the Retirement, Safety and Insurance Department of the National Rural Electric Cooperative Association (NRECA) and the Administrator of the various pension and welfare programs sponsored by NRECA for its members. NRECA is the national service organization of the approximately 1,000 rural electric systems operating in 46 states. These systems bring central station electric service to approximately 25 million farm and rural individuals in 2,600 of our nation's 3,100 counties. Our various programs provide pension and welfare benefits to over 110,000 employees and their dependents in those localities.

We endorse the principles and objectives of S. 1784 and offer suggestions on how this national retirement income policy may be improved. Not since the enactment of ERISA over ten years ago, have we debated the appropriate federal policies and incentives for widely available, adequate and secure income for retired workers. The approach taken in this legislation is to be commended for its identification of issues and its measured application of change to those areas of law.

In the development of any legislation as far-reaching and complex as the bill before the Subcommittee, there will be provisions we can endorse and others we may question. Still others, such as the provisions on Social Security integration, may be in need of further study and testing to determine if they are workable and bring about a cost-effective, responsible result. What follows represents our best professional judgment of S. 1784.

DISTINCTION BETWEEN "RETIREMENT" AND "NONRETIREMENT" PLANS

Given the broad geographic and demographic variance of our members as mentioned earlier, it is incumbent on NRECA to provide pension plan options that can be tailored to meet the individual needs of rural electric cooperatives. We believe that a defined benefit plan is as valid a plan selection for one employer as a defined contribution plan may be for another. Most of our systems are enrolled in both, with the defined contribution plan more often serving as a supplemental retirement income source. We applaud your dual retirement-nonretirement plan concept because it clearly distinguishes differences between the two types of plans on the basis of their different purposes.

Requiring an employer to establish a defined benefit or defined contribution retirement plan before installing a nonretirement plan is a sound approach for ensuring an adequate retirement income for a worker. We remain concerned, however, that an employer could establish a retirement plan without meaningful benefits in order to capitalize on making substantial contributions into a tax-favored capital accumulation plan. An annual addition limit applied on the nonretirement plan could encourage greater participation in a retirement plan. We also suggest that some tests be conducted to assure that the indexing of defined contribution plans provides comparable benefits as the indexing of defined benefit plans.

ROLE OF 401(k) PLANS

The legitimate application of cash or deferred arrangements, commonly referred to as 401(k) plans, to pension plans in providing retirement income is properly recognized in S. 1784. Restrictions on distributions from these plans should nullify its current perception as a vehicle for tax-deferral and capital accumulation. The extension of these plans to rural electric cooperative employees continues to be of the most critical importance to our members. Currently, due to a technical flaw in the tax code we are unable to offer this form of retirement savings. We are pleased that under this bill this oversight will be corrected. With regard to the coordination of contributions between 401(k) plans and IRA's, we would recommend that it be on a last dollar, not first dollar, basis. In addition to providing the worker with more flexibility in the selection of retirement vehicles, it is easier to understand and administer.

CONTRIBUTION AND BENEFIT LIMITS

We support replacing the current I.R.C. section 415 limitations on pension contributions and benefits with a level tied to the Social Security wage base. The formula put forth in S. 1784 provides for a reliable, predictable, and reasonable base for determining contributions and benefits. If we really believe in the "three-legged stool" concept of retirement income, we must make certain that the legs remain equal in size and strength. S. 1784 would accomplish that goal.

FIVE YEAR VESTING

Clearly the nation's workforce has become more mobile and the likelihood that an employee will remain long enough with one employer to earn an adequate pension benefit is diminishing. While we offer portability of pension benefits from one rural electric system to another, the general workforce lacks such a network. Therefore, we support five year cliff vesting in retirement plans and one year vesting in nonretirement savings plans. Proper plan funding and performance by plan fiduciaries should compensate for any negligible increase in plan costs that would benefit more employees prone to shorter terms of employment.

DETERMINING "NORMAL" RETIREMENT AGE

With respect to selection of age 59 1/2 as the earliest point at which an employee can receive a single sum cash distribution from a retirement plan without incurring the 20% tax penalty, we wish to note a special problem for plans whose normal retirement date is the earlier of 30 years of service or age 62. Conceivably, a participant may retire upon attaining a normal retirement age of 50 if he commenced employment at age 20. Under the bill, this worker could not receive a single sum cash payment without being subject to a 20% penalty nor would he be eligible to use ten or five year averaging. While this example may seem unusual, employees with 30 years service at age 50 through 55 is fairly common among our systems. We believe it to be more equitable for employees such as ours, who are engaged in physically demanding and high risk occupations, to be able to receive single sum distributions without penalty whenever they retire. Using age 59 1/2 as the uniform age is not an appropriate pension policy in our judgement. We feel that a retiree should be permitted to take a single sum distribution without the 20% penalty, even if not yet 59 1/2 years of age.

LUMP SUM DISTRIBUTIONS AND TEN YEAR AVERAGING

In recent years, there has been much discussion of how best to preserve retirement benefits for real retirement income needs. Unfortunate case examples of imprudent retirees misusing their lump sum distributions has distracted attention from the many legitimate uses of these settlements. While monthly retirement income certainly is the normal form of benefit payment, a prudent employee with income from other sources should be allowed flexibility to complement the quality of his life as he sees fit. At the very least, an adequate period of transition for those workers who have relied on current law in preparing for their retirement should be granted. We believe the same should be true for the capital gains treatment of pre-1974 pension benefits. With regard to ten years averaging, we could reluctantly support a reduction to a five year period with a transitional period to protect workers nearing retirement.

CONCLUSION

Once again, I congratulate the authors of S. 1784 and their staffs on this thoughtful and-innovative formulation of a retirement income policy for our nation. In the following attachment, I have outlined briefly the effects of this legislation on the plans currently administered by NRECA for its members. We remain available to assist you in any way possible with your efforts and we await your call.

TAB A

EFFECT OF RIPA ON CURRENT NRECA PENSION PROGRAM

Provision	Current	RIPA
Retirement & Security Program		
Limitation of benefits	Lesser of $90,000 or 100% high 3-year average	Lesser of $84,000 (200% SSWB) or 100% of compensation
Vesting	Graduated 10-year 100%	5-year cliff 100%
Benefit level	1% min effective salary	.5% min comp (to estb nonrtmt plan)
Distribution - retirement	Annuity or LSD w/10-yr avg, cap gains, rollover or ord income	Annuity or LSD w/rollover or ord income
Distribution - termination	Vesting or LSD w/above spl tax treatment if elig	Vesting, rollover or ord income w/20% excise (1)
401(k)	None	Available as below
Savings Plan		
Limitation on contributions	Lesser of $30,000 or 25% of effective salary	Lesser of $21,000 (50% SSWB) or 20% of compensation
Minimum contribution	1% or 0% employer	3% employer (to estb nonrtmt plan)
Required employee contribs	6% max effective salary	6% max compensation
Voluntary employee contribs	10% max effective salary	None (2)
Deductible employee contribs	$2,000 max	$2,000 max or 401(k) deferrals
401(k) employee deferrals	None	To $10,500 (25% SSWB)
401(k) employer matching	None	100% of deferrals to 25% SSWB (?)
Distribution - retirement	Annuity, installments or LSD w/spl tax treatment	Annuity, IRA rollover or ord income (1)
Distribution - termination	Annuity or LSD w/spl tax treatment	Annuity, IRA rollover or ord income w/20% excise (1)
Distribution - premature DEC	Ordinary income w/10% excise	Ord income w/20% excise

NOTES: 1. 20% excise tax on any ordinary income received under age 59-1/2.

2. Under RIPA, voluntary employee contributions allowed in separate nonretirement plan only without withdrawal penalties. Max: lesser of 25% SSWB or 10% compensation.

TESTIMONY OF THE
NATIONAL COUNCIL ON TEACHER RETIREMENT
ON S. 1784
THE "RETIREMENT INCOME POLICY ACT OF 1985"

Before the

SENATE COMMITTEE ON FINANCE

The National Council on Teacher Retirement (NCTR) is a membership organization composed of 45 state, 13 local and two territorial retirement systems, some of which serve teachers exclusively, others of which include other state and local employee groups. The total assets of NCTR's state systems are roughly $160 billion and the plans include over five million active participants. NCTR's mission is to assist its member plans in upgrading their performance and in presenting their views on federal policy issues that impact their operations.

SUMMARY OF NCTR'S POSITION:

It is NCTR's position that state administered retirement systems are an integral part of national retirement income policy, accounting for more than ______ participants. State pension systems are subject to highly detailed regulation at the state level, with extensive oversight by the state legislatures. NCTR recently documented the extent of this regulation in its report, Public Pension Plans: The State Regulatory Framework, (September, 1985 - copy attached). In large part because of the effectiveness of the regulatory framework established by the state governments, state-administered retirement systems generally perform at higher levels than do their private or federal government counterparts. More public employees participate in retirement plans than do private employees (90% as compared to approximately 74% of the ERISA-relevant work force). State retirement systems offer more diverse benefits and higher benefit levels than do private plans. And state retirement plans are better funded than either private or federal pension plans.

In short, the objectives of the Retirement Income Policy Act of 1985 are already being met by state retirement systems. Since these systems cover over 90% of state and local employees and participation in most state retirement systems is mandatory, there is literally no need to "broaden" participation or to "encourage their growth and development."

ERISA, when enacted in 1974, specifically recognized that the basic responsibility for regulating state retirement systems rests at the state level and that federal interference with this scheme might well violate basic principles of federalism. ERISA exempted government pension plans from its reporting and disclosure requirements, and its fiduciary standards as well as from a number of other key provisions. These include the requirement that plans provide qualified survivor annuities (Sec. 401(a)(11) of the Internal Revenue

Code), the minimum participation standards (Section 410 of the Code), the minimum vesting standards (Section 411 of the Code), the minimum funding standards (Section 412) and the special rules for top-heavy plans (Section 416). These exemptions recognized that state laws already insured broad pension coverage of public employees by making participation mandatory and, in addition, protected the pensioners retirement interest by defining funding and vesting standards and by protecting survivors.*/

There was no case for substituting federal regulation for state regulation in 1974. Ten years later, after extensive modernization and reform of state-administered pension systems, there is even less reason to impose ERISA-type regulations on these systems. Yet this is exactly what S. 1784 does, whether intentionally or because of inadvertent drafting. It is NCTR's position that the language of S. 1784 should be clarified to make certain that its prescriptions apply only where the problems that gave rise to it exist -- that is to private sector pension plans. In addition, consideration should be given to removing state retirement systems from the few remaining provisions of the Internal Revenue Code that regulate their administration.

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*/ NCTR recently completed a survey of the statutory and judicial interpretations of the right to a pension in twenty states. The survey demonstated that state law offers far greater protection of pension benefit interests than does ERISA, which, in contrast to state law, permits downward adjustments in not yet accrued benefits without any offsetting improvement in the participant's position.

LEGISLATIVE ANALYSIS:

S. 1784 proposes largely identical amendments to the Employment Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1954. For that reason and to simplify this analysis, all references to S. 1784 will refer to Title II of the bill which amends the Internal Revenue Code of 1954, as opposed to Title I of the bill, which amends ERISA. All references to the "Code" refer to the Internal Revenue Code of 1954.

Section 401(a) of the Code sets forth a number of requirements that must be met by a pension, profit-sharing or stock bonus plan to be "qualified" under the Code and to be treated as a tax-exempt entity. Section 204 of S. 1784 adds a new Section 401(a)(27) to the list of Section 401(a) requirements. The new provision requires each employer providing a plan for any of its employees to make certain that plan is a "retirement plan" as defined in Section 201 of S. 1784. Section 201 of S. 1784 proposes to add a new Section 414(q) to the Code, defining a "retirement plan." A plan that fails to meet the definition of "retirement plan", will violate the requirements of Section 401(a) and will thereby lose its qualified status under that Section.[*/] Proposed

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[*/] In regard to public plans, loss of qualified status is somewhat of a paper tiger. Qualified status insures tax exemption for the pension plan itself, as well as for the contribution made by the employer on the employee's behalf (the employee does not have to pay the tax normally associated with salary payments). The attempt of the federal govern-

(Continued on page 5)

Section 414(q) of the Code defines a "retirement plan" as a plan that meets the "retirement income provisions" of newly-proposed Section 409A of the Code, which would be added by S. 1784, Section 202.

A plan will not meet the "retirement income provisions" of proposed Section 409A of the Code unless it prohibits its participants from receiving distribution of any of their accrued benefits before age 59-1/2 when separated from service, or upon death or disability. The restriction on benefit distributions is written so broadly that it even prohibits distributions of funds previously contributed by the employees. Undoubtedly, this approach was taken because S. 1784 is intended to correct deficiencies in the administration of private pension plans and these plans by and large do not mandate employee-contributions. However, the provision works a severe hardship on state employees who are required by law to make after-tax contributions to their pension funds and who are authorized to recover those contributions -- with interest in most cases -- upon early separation from service.

S. 1784 creates an exception to its general prohibition of distributions prior to age 59-1/2, provided the

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*/ Continued from page four)
ment to award qualified status to state retirement systems is somewhat of an anomaly in that state entities are constitutionally immune from federal taxation. Although the employer's contribution could theoretically be taxed to the employee, this would produce a politically unacceptable consequence. The IRS has wisely recognized this by declaring a truce in the application of qualification standards to public retirement systems.

distribution is in "retirement income form." "Retirement income form," as defined in proposed Section 409A, must be either an annuity form of distribution extended over the former employee's life or life expectancy, a joint and survivor annuity or a transfer by the employer of the employee's accrued benefit to an individual retirement account (IRA), individual retirement annuity or another retirement plan, ". . . in accordance with section 411(a)(11) (the section dealing with minimum vesting standards).*/ The exception does not address the right of the state employee to recover his own after-tax contributions to the pension fund.

S. 1784's application of "retirement income form" requirements to all pension plans will have an additional negative impact on public retirement systems. Under present law, Section 417 of the Code does not apply to government plans (Code Section 401(a) last sentence). Many government plans permit participants to elect joint and survivor annuities for participants and non-spouse beneficiaries. They do not require a formal, detailed waiver from the participant's spouse as a precondition to electing a non-spouse beneficiary.

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*/ Notwithstanding the fact that governmental plans are currently exempted from Section 411 of the Code, proposed Section 409A(c) regarding the transfer of retirement funds to IRA's applies to government plans. The reference to Section 411(a)(11) in this section of S. 1784 does not extend the exemption created by 411(a)(11) because the reference is merely descriptive of the method of transfer to such IRA's or plans.

Proposed Section 409A(b)(1)(B) would require government plans to limit the availability of any annuity payable over the life of a participant and a designated beneficiary upon retirement prior to age 59-1/2, to a 'qualified joint and survivor annuity within the meaning of section 417(b).'[*] Section 417(b) of the Code defines such a qualified annuity to be for the life of the participant and his or her spouse. There is no right under Section 417(b) to designate a joint annuitant other than one's spouse. Thus, proposed Section 409(b)(1)(B) appears to impose the qualified joint and survivor annuity rules of Code Section 417(b) on government plan retirees prior to age 59-1/2 without even affording them the waiver opportunity given to private plan retirees under subsection (a) of Section 417 of the Code. It is not clear from the text of S. 1784 that this is what the drafters intended. [*] NCTR takes the position that non-spousal beneficiaries should be permitted even without a spousal waiver and that the provisions generally should not apply to government plans.

As noted above, there is presently no exemption for government plans under proposed Sections 401(a)(27), 414(q) or 409A of the Code as set forth in S. 1784. Accordingly, government plans will be technically disqualified under

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[**] This is because proposed Section 409A(b)(1)(B) limits such an annuity, if chosen, to a qualified joint and survivor annuity under Code Section 417. And, none of the other choices for "retirement income form" provide for payments to a beneficiary after the death of the participant.

Section 401(a) of the Code if they fail to meet the requirements of a "retirement plan," including the "retirement income provisions."[*/]

As mentioned above, Section 410(c)(1)(A) of the Code currently exempts government plans from the application of Section 410's minimum participation standards. Yet S. 1784 proposes to repeal Section 410(b) (S. 1784 Section 203(c)) and replace it with proposed Section 409B of the Code. This new Section will not come within the exemption provided government plans from the minimum participation standards in Section 410(c)(1)(A) of the Code. Proposed Section 409B would require government plans to cover all otherwise eligible employees whose total annual wages are below the Social Security contribution and benefit base (which will equal $42,000 in 1986). This new coverage requirement would be a condition for qualification under Section 401(a) of the Code.[**/] State retirement systems have no problem with S. 1784's mandate to cover workers whose total annual wages are below the Social Security contribution and benefit base. Such employees are already the core participants of state retirement systems. Public plans, do however, have problems with the coverage requirement, particularly as it applies to retirees who return to work or to returning workers who were separated from service for

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[*/] See Footnote at pp. 4-5.

[**/] This is because Section 203 of S. 1784 would add a new Section 401(a)(26) to the Code which would require all qualified plans to meet the coverage requirements of new Code Section 409B.

several years and who previously withdrew their employee's contributions.[*] This revision of Code Section 410 creates numerous ambiguities for public plans, many of which result from a failure to recognize that public plans are employee contributory.

Proposed Section 409B sets forth a special exception to the comprehensive coverage requirements in proposed Section 409B(b), based upon "allowable subdivisions of the relevant work force." However, it is unclear in Section 409B just how that special rule would apply to government plans. The "allowable subdivisions" are based in part on "separate product lines." Because governments do not manufacture or sell products, this distinction has no apparent application to government plans. Yet, under certain circumstances, public plans -- if covered by S. 1784 -- might want to benefit from this exception.

CONCLUSION:

NCTR commends the Committee for seeking, through the proposed legislation, to bring private plan coverage up to the level of coverage that has long characterized state retirement systems. NCTR strongly recommends, however, that S. 1784 be clarified to make certain that its provisions, designed to

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[**] A number of the larger states, for example, require a returning retiree who is receiving both salary and retirement benefits to work several years before he can accrue benefits in a second retirement account.

correct deficiencies in private plan administration and operations, do not apply to governmental plans. This can be done by adding to the last sentence in 401(a) a phrase excluding government plans from the coverage of new sections 401(a)(26) and 401(a)(27) proposed by S. 1784. Coverage of government plans would be superfluous since these plans are already adequately regulated at the state level and are not characterized by the deficiencies that S. 1784 seeks to address. Instead of improving plan performance, application of S. 1784 to government plans would only add to their administrative costs.

NFIB® National Federation
of Independent Business

The Guardian of Small Business

SUBMITTED STATEMENT OF

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Before: Senate Subcommittee on Savings, Pensions, and Investment Policy

Subject: S. 1784, The Retirement Income Policy Act of 1985

Date: 2/11/86

Mr. Chairman, on behalf of the more than 500,000 members of NFIB, I want to thank you for this opportunity to present the views of our nation's small employers on S. 1784, the Retirement Income Policy Act of 1985. Both you and your colleague, Senator Chafee, are to be commended for tackling the problem of articulating a national retirement policy. The need for this hearing becomes more and more apparent when viewed in light of the reduced ratio of workers to Social Security recipients that is projected for the coming years.

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Just as you have attempted to provide a comprehensive framework for this debate, so, too, will our remarks range over an equally large area, running the gamut from the negative influence of increasingly burdensome payroll taxes on labor-intensive small firms to the particulars of a recently completed NFIB member survey on employee benefits.

Pension Costs as a Factor in Labor Costs

From the perspective of Congress, the need for a national retirement policy is based on the imperative to reduce the considerable reliance on Social Security as a national retirement plan. To be practical, a national retirement policy must balance other important considerations and motivations of employees and employers besides retirement. Additional considerations for a retirement policy must include the advisability of mandating new employment costs that result in job reductions or of requiring employees' pension savings to the exclusion of other savings needs and goals. Both of these issues must be considered and fully explored before formulation of a national retirement program.

Impact of Employment Tax Increases

A national retirement policy that is based solely on employer contributions, and which places the employer in the position of responsibility for the employees' retirement savings, runs the risk of endangering the very jobs that provide current (and future) wages and retirement plans. Jobs and more jobs are the key to a national retirement policy, and a retirement policy that has the effect of reducing jobs should be rejected .

The importance of small business employment to the national economy is worth illustrating. According to the State of Small Business Report of the President (May, 1985), industries dominated by small businesses realized employment growth of 11.4% during the period of 1982 through 1984. Over the same time period large business dominated industries realized a job rate increase of 5.3%. Total employment in small establishments reached a level of nearly 87 million in 1982, according to the small business data base .

The major goal of our economy, given our trade and budget deficits, must be to increase the number of people working. To accomplish that, our employment policies must include encouraging and increasing the number of small businesses that employ people. If we eat the goose today, it is going to be terribly difficult to have omelettes for breakfast tomorrow.

Small business economic growth is inextricably tied to labor costs. Labor costs and mandated federal taxes for Social Security and unemployment compensation are the primary concerns for labor-intensive small businesses. In 1980 a study of small business tax burdens revealed a startling fact: over 70% of the tax burdens of small businesses sampled resulted from employment-based taxes. These taxes include the usual list of suspects, but the chief offender is the Social Security tax. Since the time of this study, the employment tax burden has most certainly increased, for in 1983 Congress determined that the only way to stave off the bankruptcy of the Social Security system was to raise Social Security taxes.

As an economic issue the impact of increased labor-based costs on small firms is widely misunderstood even by many economists. Most of them consider the impact of payroll-based taxes to be the same as any other cost of business because they are allowable business deductions. They have therefore concluded that there is no possibility for any discriminatory treatment of small firms under these conditions. However, when comparing smaller firms to larger ones in the context of payroll costs, all factors are not equal.

First, small firms are at a disadvantage because they are in lower tax brackets. This means that the federal treasury is subsidizing only 15¢ on the dollar of deductible payroll costs for a small firm, while it is subsidizing 46¢ on the dollar of these costs for a large firm. Secondly, all other market and economic factors are not equal. A small firm cannot be expected to automatically pass through an increase in employment taxes to the consumer in the same fashion or with the same ease as a large business. The large business has a greater ability not only to absorb costs in the short term, but to create prices in the long term.

Evidence points to the conclusion that, in the case of a small firm, both the employee and the employer must absorb new employer based taxes in the short term. In the longer term it is far less clear how much is passed through or absorbed, though it is sure that not all of the cost is passed through even in the long term. The impact of these increased taxes (which must be absorbed) on the profitability of a small firm should be obvious. Deprived of its major source of capital for growth, a small firm's first reaction is not to hire a new worker or, in a worst case scenario, to lay off a current worker.

In small firms, productivity and capital formation are not simply a matter of machines. Labor capital is far more important to small firms than machine capital.

Employee Goals

Recently a member related to me his reasons for cancelling his business' retirement plan. Primary among them was the problem of employees who would quit so that they could cash out their pension fund and use it to buy a house. One year after quitting they would seek to come back to the firm. According to this member, current retirement policies have failed because the rules encourage short term employment. In addition, the rules fail to recognize that employees have other goals in life and that they will want to obtain control of any large amounts of funds in their name for legitimate uses, especially if they are relatively far away from retirement.

This must be a concern because if the tax deferral feature of retirement policy is encouraged to the exclusion of all other savings needs, how will people buy homes and provide for their children's education? Encouraging retirement savings is a worthwhile goal, but not if savings for other purposes is discouraged. The fact is that many employees are unable to save at the time they are working; pension funds, especially defined contribution plans, are a form of forced savings.

By mandating that any deferred compensation in a qualified plan cannot be paid out to an employee prior to retirement, S. 1748 would create a very difficult problem for employers and may hurt the always delicate employee/employer relationship.

Cost Increase Concerns

S. 1748 would result in retirement plan cost increases due to several provisions of the proposal. First, the proposal would eliminate the ability of an employer to integrate benefits with Social Security. Second, the proposal eliminates the ability of the firm to provide profit sharing plan benefits. Third, the proposal would mandate limitless portability of pension funds on behalf of employees, creating long-lasting paperwork burdens.

Paperwork Burdens and Portability

Ever since the enactment of ERISA, a major concern of small business owners with their pension plans (and a major impediment to many small firms establishing pension plans) has been the inherent paperwork burdens. The burden of paperwork to satisfy the IRS, the Department of Labor, and the Pension Benefit Guaranty Corporation, all of whom are in constant need of facts and figures, keeps many employers away from establishing plans. Once a plan is established, the responsibility of a small employer includes not only the annual report of the plan to its participants, but the requirement for a lifetime file on each employee.

Portability would only exacerbate this already difficult problem because it would require an employer to keep track not only of current employees, but of all past employees, too. Untold new complexities would result as employers are forced to keep track of former employees and the changes which occur in their lives--such as divorces and relocations to another city or even another state. The employer would be placed in the position of having to know more about a person after he or she leaves a job than while he or she is on the job just to meet this retirement policy goal. Portability would also result in an employer finding one more reason for cancelling or not starting a retirement plan. Since 35% of our survey respondents who had previously cancelled a retirement plan cited changing and complex regulations as the reason they ended their plans. We must be concerned about instituting portability with the employer bearing sole responsibility for paperwork and records. Our survey indicates that the result of increased employer responsibility for records and paperwork would be that the employer would find it far less expensive, in both the short and long term, to simply give the employee the money in wages that the employer might otherwise have placed in a pension plan.

Mandated Employer Contributions--Elimination of Integration

An employer is currently allowed to integrate the benefits of a qualified plan with social security benefits. This allows an employer to reduce his current contributions by an amount equal to the retirement benefits social security will provide. Integrating private retirement with social security benefits allowed an employer to provide a specified level of retirement income to an employee by taking into account social security benefits the employee will ultimately receive and for which he is also paying FICA taxes.

S. 1748 seeks to relieve financial pressure on the Social Security System and so eliminates the ability of an employer to integrate a qualified pension with social security for all employees whose earnings fall below the Social Security wage base. This portion of the proposal would require an employer to make a minimum contribution on behalf of each employee of 3% of compensation, without integrating benefits with those manda-ed by Social Security.

As a result of the proposed legislation, an employer may suddenly find that he or she is paying a substantial amount of money on behalf of each employee for two mandated retirement systems. The employer shoulders the burden of funding both systems while the employee remains free of any responsibility.

Employer Benefits

It is commonly held that small business owners like current pension rules because they receive the lions' share of benefits. This fact is strongly refuted by our survey, which reveals that half of the respondents who established plans established them for the benefit of employees, while only 11% cited their own benefit as a reason. This is a key point because employers will be able to take care of themselves regardless of whether there is a company plan. Employees are the ones who benefit the most from a retirement plan. In the interest of public policy, employers should be encouraged to have plans and not be discouraged by proposals that impart so much in costs to an employer and no responsible role to an employee.

At this point, I would like to turn now to our recent employee benefit survey to share with the Subcommittee the facts we have garnered from small business with regard to retirement plans.

In September 1985, NFIB surveyed 7,750 of its members on the subject of employee benefits, with a particular focus on health insurance and pension plans. Attached is an appendix showing how those surveyed reflect the small business universe. You will find that our survey and the respondents match very closely. Given that fact, we feel very comfortable in the following analysis of the data received.

The survey established that there exists a hierarchy of benefits that are introduced into the workplace by the employer on behalf of full-time employees. The first among these is paid vacations; 59% of small firms surveyed provided this benefit to all full-time employees, and an additional 18% provided it to some employees. Provision of health insurance followed closely behind, with 42% for full-timers and 23% for some full-timers. Almost even were paid sick leave for all or some full-timers, at 34% and 14% for the two categories, and life insurance at 33% and 16% respectively. Not surprisingly, retirement plans were the last type of employee benefit to be offered by an employer.

I took this rather circuitous route to illustrate to the Subcommittee that, in the eyes of small employers, there are more immediate needs that have to be addressed before a retirement plan is even considered.

Roughly one out of four NFIB members provides a retirement plan for his or her employees. Eighteen percent provide this to all full-time employees, and another 8% provide it to some. The survey results showed, not surprisingly, that pension coverage increases along with firm size. Only 14% of those firms with four or fewer employees provided a retirement plan either to some or all of their full-time employees. In contrast, 54% of those firms with over 50 employees provided a pension plan to all their full-time employees, and an additional 20% provided it to some.

With regard to the type of plan, the most common was the defined contribution (39%). Second was the defined benefit plan (27%), then far in last place were multiemployer plans, cited by just 5%. This last type of plan was limited solely to firms with union employees.

The most favored type of defined contribution plan was profit sharing (35%). 401(k)'s and SEPs each represented about 6% of the total. The interesting fact about profit sharing is that almost as many people selected this choice as did defined contribution. The implication is that profit sharing is often an additional benefit not specifically considered to be a retirement program. Herein lies a possible problem with S. 1784 and its distinctions between retirement and non-retirement programs.

For the employers who currently provide profit sharing as a "non-retirement" benefit, it is likely that they would terminate the plan rather than make the necessary changes for it to become a qualified plan. Many small employers will be deterred by the mandated costs associated with pension plans in general and S. 1784 in particular. The 3% contribution of annual salary for a defined contribution plan under the bill may prove too costly for those small firms with insufficient profit margins to fund such plans.

In this event, employees lose both ways. Not only do they not have a retirement plan, they also lose additional income previously available from the non-retirement profit-sharing plan.

When asked why they started a plan, 29% stated that it was to keep valued employees. The second highest response (24%) was that the employees needed a plan--it was the right thing to do. Therefore, over 50% of the respondents cited employee-directed reasons for plan formation. The most important asset to a small business is its people. It is in the employer's interest to provide, as best he or she can, employees with wages and fringe benefits that are both affordable and competitive.

The choice of which pension plan to offer is heavily influenced by advisors. This is generally due to the complexity of the issue as well as the fact that small employers do not have that much time to devote to such matters. Of those with defined contribution plans, 44% cited contribution flexibility as the reason they chose that particular plan over another. Here is another area where S. 1784 may actually be a disincentive to small firm plan creation. The bill mandates a 3% contribution of annual salary by an employer with a defined contribution plan. For many firms with profit sharing, this would destroy one of the more important features that encourages their participation.

Currently an employer contributes to a profit-sharing plan when he or she has a profit to share. They have flexibility from year to year as to the amount distributed. Under S. 1784, they would be required to contribute 3% of each employee's annual salary. What if there is no profit one year? Does the employer then have to make a 6% contribution in the following year? What if the profit in the second year is not sufficient to pay for a 6% distribution? We firmly believe that further attention needs to be paid to these concerns.

One area where S. 1784 is right on target is in acknowledging that constant governmental change of pension laws and regulations [illegible] a major deterrent to plan sponsorship. Close to 40% of pension plan respondents cited this constant change as a major problem. Couple this with those who cited administative costs (8%), and you come up with a sizable disincentive.

The important point to remember is that not only do we want to gauge the impact of S. 1784 (or any pension legislation for that matter) on current plan sponsors, we want to measure also how these changes may impact those small employers who are on the outside looking in. Thirty-nine percent of those without plans cite affordability as the reason they haven't set up plans--a reason that which includes both cost and profitability. The Subcommittee would be well advised to examine S. 1784 in light of this fact so that the bill will not raise the cost of retirement plans, thereby keeping them out of the reach of those seventy-four percent of small firms that currently do not have pension plans.

One of the more surprising findings of the survey was the responses to the questions concerning factors governing employee participation in plans. Fifty-nine percent of respondents required one year or less of employee service for inclusion in a plan. Equally surprising, almost fifty percent vest their employees after five years.

Turning directly to S. 1784, NFIB would like to offer the following observations. We applaud the choice of the sponsors of S. 1784 to seek the establishment of a coherent national retirement policy. This is to be preferred to the much-too-common practice of toying with the system to generate revenues for the government. In the same breath, though, we must state our concern about the subtle message the Congress is sending to employers and employees alike in this legislation--that Congress "knows what is best" and that it is trying to protect us from ourselves. People clearly have a responsibility to plan their lives; retirement is a part no more and no less important than having a child or buying a home. Government, too, has a duty to assist its citizens in meeting some of these shared goals. The question this Subcommittee needs to examine or re-examine with regard to retirement coverage is: how far do you go?

Conclusion

A stated purpose of a national retirement policy is to ensure that individuals have sufficient funds saved for retirement. Additionally, there is a stated need to relieve the financial pressure on the social security system which, provides a substantial amount of retirement income. However, we are concerned that any proposal for a national retirement system which mandates coverage as wide as S.1748 proposes might become a parallel social security system and generate ever-increasing employer responsibility and cost for employee retirement without consideration that jobs are at stake.

Should the private sector be forced to deal with the reality of a new national retirement policy before Congress comes to grips with the financial realities of the social security system?

We wish to thank you for the opportunity to address our concerns with this proposal and we are availiable to discuss our concerns with you.

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SURVEY SAMPLE

The preceding report was based on data gathered from a mail survey of small business owners conducted in September, 1985. The survey sample was randomly drawn from the membership file of the National Federation of Independent Business (NFIB). All regular members in the file were eligible for selection, the exception being a comparatively small percentage who had no full-time employees. Thus, the resulting sample consisted entirely of small employers. Each of the 7,750 small business owners in the sample received a questionnaire (a copy provided in Questionnaire, p. 46) and a follow-up two weeks later. There were 1,439 usable responses for a 19% response rate, 11 percentage points less than NFIB normally experiences in such surveys.

There is little a priori reason to fear a sample bias. Dunkelberg and Scott have demonstrated that the NFIB membership file reasonably reflects the universe as the universe can best be estimated.*/ Moreover, the sample was not contaminated by association activities involving extensive sale or promotion of employee benefit packages. And while response rates of 30%, let alone 19%, never can provide a survey analyst comfort, previous experience in comparing NFIB-collected responses to equivalent data collected by other organizations shows remarkable consistency, particularly within size class. The differences that do exist usually involve "levels" for the entire population resulting from the somewhat larger businesses within the NFIB file.

Tables A and B provide comparisons of the estimated universe, the survey sample, and the survey respondents. (The estimated universe measures were drawn from the Small Business Administration's (SBA) Small Business Data Base as published in the annual The State of Small Business Report.) Note on Table A that the industry-by-industry differences in these data sets are minimal. Survey respondents are somewhat overrepresented among manufacturers and underrepresented among services. In the other major industries, however, differences usually involve only a percentage point or two.

When employee size is substituted for industry in the three set comparison (Table B), the result is not as satisfactory. The profile of survey respondents and the survey sample are virtually identical, with the exception of 1-4 employee class size and "no answer." Distributing the no answers proportionally among all size classes creates a survey respondent profile still somewhat underrepresented in the 1-4 employee class and a percentage point or two overrepresented in the others. That distribution in and of itself should be sufficient to cover all concerns over the response rate. However, the responses of "no answers" and the responses of other size classes to other comparable questions produce an uncommon similarity between the "no answers" and the 1-4 employee size class. Given that similarity and previous experience which indicates the smallest are most likely not to respond to size questions, responses proportionally allocating "no answers" probably do not assign enough to the smallest size class. As a result, the profile of survey respondents and the survey sample is probably even better than the considerable similarity previously shown.

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*/William C. Dunkelberg and Jonathan A. Scott, Report on the Representativeness of the National Federation of Independent Business Sample of Small Firms in the United States, Small Business Administration, 1984.

Table A

COMPARISON OF ESTIMATED UNIVERSE, SURVEY SAMPLE, AND SURVEY RESPONSES BY INDUSTRY
(in percent)

INDUSTRY	ESTIMATED UNIVERSE	SURVEY SAMPLE	SURVEY RESPONDENTS
Construction	14	11	12
Manufacturing (includes Mining)	9	13	13
Transportation	4	3	4
Wholesale	10	7	10
Retail	29	27	27
Agriculture	4	5	5
Financial Services	8	7	9
Services	24	24	19
No Answer	--	2	1
Total	100%	100%	100%

While the estimated universe inflates the 1-4 employee size class a percentage point or two by inclusion of some non-employers, there remains a difference between the estimated universe and the sample. Sample small business owners (as well as respondents) have somewhat larger businesses on balance. The estimated universe contains approximately 10 percentage points more firms in the 1-4 employee size class than did the sample on the response. Those 10 percentage points were distributed over other size classes. Thus, population "levels" are unduly influenced, though not greatly, by owners of firms larger than 1-4 employees.

Table B

COMPARISON OF ESTIMATED UNIVERSE, SURVEY SAMPLE, AND SURVEY RESPONSES BY EMPLOYEE SIZE
(in percent)

EMPLOYEE SIZE	ESTIMATED UNIVERSE	SURVEY SAMPLE	SURVEY RESPONDENTS
1-4	57	48	37
5-9	21	21	21
10-19	11	15	15
20-49	7	11	10
50-99	2	3	4
100 or more	2	2	3
No answer	--	1	11
Total	100%	100%	100%

National Coordinating Committee for Multiemployer Plans

SUITE 603 • 815 SIXTEENTH STREET, N.W., WASHINGTON, D.C. 20006 • (202) 347-1461

STATEMENT OF ROBERT A GEORGINE, CHAIRMAN NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS ON S.1784, THE RETIREMENT INCOME POLICY ACT OF 1985 BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY, COMMITTEE ON FINANCE, UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to present this statement in connection with your hearings on S.1784, the Retirement Income Policy Act of 1985. I am making this presentation in my capacity as Chairman of the National Coordinating Committee for Multiemployer Plans (the "NCCMP"). The NCCMP was organized shortly after the enactment of the Employee Retirement Income Security Act ("ERISA"), more than eleven years ago, in order to represent the interests of the more than eight million men and women, and their families, who are covered by multiemployer employee benefit plans. The Coordinating Committee's affiliates are located in all regions of the United States and include more than 175 pension funds, health and welfare funds and their sponsors.

I applaud you, Mr. Chairman, for keeping the issue of retirement security in the forefront of the national debate on domestic priorities. Indeed, there is no subject matter which is of greater importance to America's workers today, especially in view of the apparent willingness by the Administration and some legislators to propose Federal legislation which would effectively cut back or outright eliminate many employee benefits which workers have earned for themselves and their families.

The NCCMP and its affiliates are deeply concerned about the continued viability of collectively bargained employee benefit plans. These plans provide a wide range of essential benefits to millions of Americans who otherwise could not afford them. They permit employees and their families to meet medical expenses during times of crisis and encourage preventive health care. They protect dependents against financial disaster in the event of an employee's premature death. They provide funds for basic necessities for unemployed and disabled workers and their families. They provide educational assistance and legal services for many lower and middle income Americans who could not otherwise afford access to these benefits. And, these plans provide the critical financial security necessary for employees to live their lives in dignity after retirement from the workforce.

America's system of encouraging the dedication of a part of each workers' wages to meeting certain basic human needs, such as retirement income, is fundamental to a stable, progressive society. We, as a nation, have made enormous progress during this century in fashioning a national policy of fostering these benefits through a combination of public and private programs. On the public side, the establishment of the Social Security system is, of course, fundamental to this national retirement policy. But, Social Security offers only a benefit floor. It is the private system of employer financed employee benefits which has nurtured the well-being of the vast majority of American workers and their families.

Nonetheless, a disturbing trend appears to be developing to curtail the incentives which have played a key role in the development of benefit plans. Most recently, the Deficit Reduction Act of 1984 imposed new limits on contribution deductibility and subjected the earnings of employee benefit funds to new taxes on so-called unrelated business taxable income. That Act also repealed the estate tax exclusion for benefits paid from pension plans. Before that the TEFRA legislation subjected pension benefits to withholding taxes and imposed other restrictions and burdens on employee benefit plans. And, although the 1985 House-passed tax legislation would not impose new direct taxes on most forms of retirement or health care benefits as the Administration would have liked, the fact is that in the name of "reform" that pending legislation continues the trend of making it more and more difficult for the system of private pension plans to meet their objective of providing a decent retirement income for plan beneficiaries.

Mr. Chairman, as you pointed out in your statement at the opening of these hearings, we face ". . . a great challenge -- the task of encouraging our voluntary system of employer-sponsored pensions to deliver substantial retirement benefits to a broad cross-section of American workers." Moreover, as you noted, "[s]everal decades from now the average person may be living nearly as many retired years as working years . . . [and] younger workers today may have to earn their retirement benefits over a short period relative to the time they will be dependent on the benefits they have earned." One of the problems we face in that regard is that too many younger workers feel they have plenty of time before they have to worry about obtaining adequate retirement income. They believe they can provide such income for themselves through IRAs or otherwise, once they get ahead and have money to invest. Thus, if the direct cost of their retirement benefits were increased through higher tax burdens, they would likely drop out of plans or ask their bargaining representatives to terminate such plans.

However, experience has shown that younger workers, especially lower-paid workers who have few discretionary funds, will not make adequate provision for their own retirement benefits through IRAs or otherwise. In addition, the financial security of current retirees, whose benefits may not be fully funded at the time of plan termination, could be seriously jeopardized by any reduction in the incentive for maintaining such plans. This would be especially true in newer plans providing past service credit. That is why we applaud the pivotal concept in S.1784 -- to distinguish between retirement and non-retirement benefit plans and to encourage the further expansion of employer sponsored retirement plans.

Providing these benefits through tax subsidized private sector programs is far more cost-effective than providing them through government programs. On the cost side, particularly with respect to pension benefits, there is evidence that tax expenditures are nowhere near as high as the Department of Treasury estimates. Tax expenditure measures used in the budgetary process are calculated on a cash-flow or cross-sectional basis.

Thus, the amount of taxes deferred by current pension plan participants is offset against the amount of taxes paid by current beneficiaries. This is an unrealistic measure which fails to distinguish between taxes deferred and taxes permanently lost to the Treasury. When tax benefits are measured in a lifetime context, with the amount of taxes deferred by particular participants offset against the amount of taxes that will eventually be paid by the same participants, the revenues lost to the Treasury decrease significantly. The absolute dollar value of tax expenditures, measured in a lifetime context, is only about one-quarter the value of deferred taxes. Even after a present-value adjustment to reflect the interest foregone by the Treasury, the value of lifetime tax expenditures is less than half that of deferred taxes.

Even lifetime tax expenditure measures ignore the likelihood that higher-income taxpayers would invest in other tax-preferred assets (e.g., housing, state and local government bonds, or assets purchased for capital gain) in the absence of employer-paid pensions. Thus, a change in the current favorable tax treatment of pensions would probably not recover even the lower federal revenue expenditures estimated on a lifetime basis.

In short, the private sector retiree benefit program is a "good buy" in terms of tax expenditures. That is why the basic legislative goals found in S.1784 -- to improve the environment for the continuation and expansion of private retirement plans -- are ones which the NCCMP strongly supports.

Mr. Chairman, while it is apparently more fashionable these days to focus attention on the various types of defined contribution plans, the facts are that defined benefit pension plans have remained popular and are growing. This is true both in terms of single- and multi-employer plans. And the reasons for this continued growth are clear. A defined contribution plan may help certain employees save a specific sum of money to be available for numerous contingencies, only one of which may be retirement. Even an IRA can be tapped by an employee prior to his retirement years. Thus, defined contribution plans are merely a form of savings. And while S.1784 does not favor defined benefit plans over defined contribution plans, we feel it is important for you to recognize and consider the several ways in which defined benefit pension plans are superior.

First, defined benefit plans provide strong incentives for a worker to remain with his or her employer or, in the case of multiemployer plans, to remain in the trade or craft covered by the plan. This makes for a stable and skilled workforce which contributes to our economy as a whole. Moreover, defined benefit plans encourage a more systematized approach to retirement in that there is a direct and positive correlation between the level and timing of pension benefits and the age at which workers retire. A regular monthly check payable at a definite time is a far more powerful retirement incentive than a one time receipt of a undeterminable lump sum.

Second, defined benefit plans can be adapted by employers to a wide variety of circumstances. Most important of these is the ability, through a defined benefit plan, for an employer or group of employers to provide meaningful levels of benefits for older employees by granting past service credit.

Third, as pooled investment vehicles, defined benefit plans can use their large assets in ways which are simply unavailable to managers of defined contribution plans. The stucture of defined benefit plans allows a plan sponsor to know what it will need during any specific time period, thereby assuring greater flexibility in making investment decisions -- flexibility which allows for more creative uses of pension assets and higher returns over the long run. This, in turn, means the possibility of benefit increases and lower or more stable employer contribution obligations.

Finally, if for some reason investment returns or the ability to make contributions fall short of the need to pay promised pension benefits in a defined benefit plan, it is the plan sponsor -- not the individual plan participant -- who will bear the deficiency because the promised benefit must be paid. And, if the plan sponsor cannot meet its plan obligations, Title IV of ERISA guarantees the payment of benefits through the pension guaranty program which, in essence, puts the community of all defined benefit plan sponsors behind the promise of each individual plan.

Mr. Chairman, with the goal of expanding worker participation in and access to private, employer-sponsored retirement plans, S.1784 makes some fundamental modifications in current law regulating those plans. For example, recognizing that work force mobility creates difficulties for certain workers to qualify for benefits under plans with a ten-year vesting schedule, the bill would change current law to require plans to provide full vesting after five years rather than the current maximum. The NCCMP is, of course, pleased that your bill recognizes that such a change is not necessary for multiemployer plans since those plans are structured precisely to accommodate the problems of worker mobility from employer to employer in the industries which those plans cover. However, whether it be a change in vesting requirements or modifications of rules governing coverage and integration with Social Security or limits or deductions, contributions and benefits, it is critically important for this Subcommittee and the Congress as a whole to understand all of the implications of policy and regulatory changes which you contemplate making in our private retirement income system. Responses to short range needs are no substitute to careful and studied analysis of what is best for our society in the long run.

In 1974, the Congress enacted one of the most important pieces of public policy legislation ever to emanate from the legislative process. That legislation -- ERISA -- was a clear statement of national policy that we must continue to encourage and foster employee benefit plans while at the same time assuring that the assets and resultant benefits of these plans are fully protected for the current and future enjoyment of plan participants. Congress said at that time that it is only through the private sector that we are going to be able to assure meaningful levels of retirement, health, education and other welfare benefits. Congress said that these benefits are to be earned in the workplace and that the marketplace will determine how high or extensive these benefits will be. And Congress said that once employers and employees establish various types of benefit plans, those plans will have to meet certain basic minimum standards so that the promise to pay those hard earned benefits is not illusory. It is not a perfect policy and will continue to require some fine tuning like that which took place in 1980 with MPPAA and in 1984 with REA. Moreover, as the NCCMP has been urging for years, we need a more rational regulatory approach by placing all jurisdiction over employee benefit plans in one agency dedicated to the preservation and flourishing of employee benefit plans. Let it not be said, however, that we have no national benefits policy or that it is a serious failure. The fact is that our current policy should not be discarded or replaced in a casual manner.

Once again, Mr. Chairman, I applaud your current effort to encourage the growth of private employer sponsored retirement plans. To the extent that the NCCMP can continue to be helpful in the process, we are ready, willing and, as always, available. If we are to succeed in this shared goal, we must look carefully at whether there is in fact anything wrong with the current system. If there really are significant problems with the present policy, those problems -- and their solutions -- must be targeted with precision. However, we must avoid unnecessary tinkering that would jeopardize the health of the employee benefit system. If we stay true to this course, we can continue to hope for a credible non-partisan approach to employee benefit plan regulation.

PREPARED STATEMENT OF THE NATIONAL SENIOR CITIZENS LAW CENTER, PREPARED BY MARILYN E. PARK, STAFF ATTORNEY, WOMEN'S PENSION EQUITY PROJECT, NATIONAL SENIOR CITIZENS LAW CENTER

The National Senior Citizens Law Center (NSCLC) is a national support center specializing in the legal problems of the elderly poor. We are pleased to accept Senator Heinz's invitation to submit a written statement for the record.

NSCLC is funded by the Legal Services Corporation, the Administration on Aging of the Department of Health and Human Services, and private sources. We provide support services to legal services attorneys and aging advocates as well as members of the private bar in addressing the legal problems of their elderly clients. In that capacity, NSCLC has conducted extensive litigation in the private pension area. Private pensions are a critical issue for the elderly poor. Many would not be struggling to survive at or below the poverty level if they had pensions to supplement their Social Security income.

We have recently received private funding from the Ford and Rockefeller Foundations to establish a Women's Pension Equity Project to conduct research, policy analysis and public education on sex-based differentials in the private pension system. Our research will include an analysis of the economic factors underlying this inequality. There is a serious need for additional data on this subject to assist policymakers in most effectively targeting reforms in the current system. The Project will also conduct conferences where representatives of the pension industry, employer groups, labor unions, and aging, women's and civil rights organizations can exchange ideas and define areas of consensus. In addition, we wish to remain responsive to requests from lawmakers for information and other assistance on the subject of pension equity.

It is very encouraging that this Committee is moving forward with pension reform. The problem of pension inequity for women is reaching crisis proportions. Women constitute 59% of the American population over age 65, but 71% of the aged poor.[1] Poverty afflicts 36% of single older women.[2]

Private pensions are a critical component of adequate retirement income. Only 2% of the elderly who receive both a private pension and Social Security live in poverty. In contrast, 31% of persons receiving Social Security but no pensions fall below the poverty line. For Social Security recipients without pensions or other income, the incidence of poverty soars to 55%.[3] Not surprisingly, only 10% of women over age 65 receive private pensions, while 29% of men over age 65 do.[4] The median private pension for men age 65 or over is almost twice that for women.[5]

The Retirement Income Policy Act offers a much brighter picture for female retirees in the future. Without such structural changes in the private pension system, current inequities will not diminish significantly. The size of a pension check is obviously strongly related to the size of a paycheck. While the earnings gap between male and female workers may be narrowing by a few points, there is unanimity that it will remain substantial for the indefinite future.

The bill's comprehensive strategy for preventing capital accumulation plans from encroaching on conventional retirement plans and its affirmation of Social Security as a universal benefit program are critical to protecting the low income worker upon retirement. With respect to specific provisions of S.1784:

1. Proposals in S.1784 to shorten the vesting periods of retirement and non-retirement plans to 5 and 1 years, respectively, will go far towards improving pension income for female workers, who move in and out of the labor force more often than male workers. However, NSCLC urges this Committee to delete any exemptions for multi-employer plans. Such exceptions will arbitrarily hurt employees in declining industries who do not have new jobs to carry their pension credits to upon the loss of their old jobs. We also support an additional provision, not currently in RIP, that would allow part-time employees to vest.

2. Proposed limits on integration in S.1784 will also benefit low earners significantly and are a step in the right direction. As a result of current integration rules,

low-paid female employees may end up with little or no pension benefit, even though they participated in a pension plan until retirement -- and even though their employers received tax benefits and adjusted payscales to compensate for plan contributions. However, NSCLC urges this Committee to examine whether there should be integration offsetting in any amount, in light of current inequities in pension distribution.

Recently, the NSCLC successfully litigated an integration issue of first impression in Dameron v. Sinai Hospital of Baltimore (Civil Action No. M-83-2835, D.Md., Jan. 16, 1986). The plaintiff's plan had been calculating pension benefits by integrating them with estimated Social Security benefits. These estimates were severely skewed to result in an offset figure which was higher than the person's actual Social Security benefit. The low-paid female employee who had entered or re-entered the labor force late in life was particularly disadvantaged by this method. The plan's estimates for Social Security benefits were based on employees' recent earnings, which were, for recent labor force entrants, obviously higher than their earnings over their lifetimes. In addition, it assumed a lifetime earnings record. These inflated SSA benefits were often 100% higher than actual benefits, thus substantially reducing the employee's integrated pension benefit. The federal district court in Dameron ruled that this integration method was invalid under ERISA and ordered full retroactive and prospective pension benefits. Unfortunately, this method is still being used by many other, particularly small, plans throughout the country.

3. Mandatory coverage for workers earning less than the Social Security wage base is another positive feature of S.1784. This will be also particularly helpful in ensuring some retirement income for female retirees.

4. The additional employer incentives for Single Employee Pension Plans provided by S.1784 will assist in expanding coverage among small companies. We also support the bill's added protections for employees. However, NSCLC opposes the proposed 25 employee limit for SEPs as an arbitrary cutoff and as inconsistent with the bill's overall intent to encourage voluntary employer-sponsored retirement plans.

5. NSCLC would also like to see several other needed reforms not currently part of S.1784:

a) Coverage should be extended to older employees approaching retirement age and those working beyond age 65. While pension reform cannot address most past inequities, coverage of older workers could be of great benefit to low paid women employees who have recently entered or re-entered the labor force.

b) Inflation makes small pension checks even smaller. We urge the Committee to include a provision to study and otherwise move toward indexation of pension benefits.

Current pensioners are dependent on ad hoc benefit increases given (or often not given) at their employers' discretion.

c) Finally, we are beginning to see problems in the implementation of the Retirement Equity Act of 1984. This Act is very beneficial for the spouse of a private pension participant in a number of ways. However, divorced and separated spouses of pension recipients may still have difficulty receiving an equitable share of pension income. Effectiveness of legal representation, variations in state divorce laws and individual judges are playing a significant role in the process of seeking a share of pension income through a "Qualified Domestic Relations Order", as defined by REA. We urge the Committee to monitor both the future effects of this provision and REA's joint/survivor benefit provisions.

We thank you for the opportunity to submit testimony on these very important issues.

Legal Defense Fund

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WRITTEN TESTIMONY OF THE NAACP LEGAL DEFENSE AND EDUCATIONAL FUND, INC. BLACK WOMEN'S EMPLOYMENT PROGRAM

ON

S. 1784--THE RETIREMENT INCOME POLICY ACT

SUBMITTED TO THE

SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
SENATE COMMITTEE ON FINANCE

FEBRUARY 10,1986

Charlotte B. Rutherford
Terisa E. Chaw
Black Women's Employment Program

Contributions are deductible for U.S. income tax purposes

The NAACP LEGAL DEFENSE & EDUCATIONAL FUND is not part of the National Association for the Advancement of Colored People although it was founded by it and shares its commitment to equal rights. LDF has had for over 25 years a separate Board, program, staff, office and budget.

SUMMARY OF TESTIMONY

FACTS

1. The availability of private employer-provided pension plans traditionally has been tied to the better-paying industries and occupations in the nation's workforce.
2. Black women are disproportionately underrepresented in those better-paying industries and occupations and therefore, few Black women have been able to participate in private employer-provided pension plans.
3. Over half of all Black female heads of households earn wages that are at or below the poverty level.
4. 80 percent of elderly Black women who live alone are in poverty.
5. Only 22 percent of all Black women 55 years and older had ever received income from any type of employer-provided pension plan, whether public or private, in 1982.
6. Only five percent of all elderly Black women received income from a private employer pension plan in 1984.
7. 30 percent of single elderly Black women depend entirely upon Social Security benefits for their income and nearly 90 percent depend upon Social Security benefits for half of their income. The average annual Social Security benefit received by elderly Black women was $2,304.

RECOMMENDATIONS

1. Private employer-provided pension coverage should be available to all workers, especially those who work in low-wage occupations.
2. Private employer-provided pension coverage should be available to part-time workers with 500 or more annual work hours.
3. Private employer-provided pension coverage should be available to new employees who are 65 years old or who are within five years of retirement age when they enter that workforce.
4. Vesting requirements should be no more than five years for all private pension plans, including multiemployer plans, and they should apply to part-time workers who are employed 500 hours or more annually.
5. The practice of integrating social security and pension benefits should be eliminated. The Act should establish a required minimum pension benefit amount to be paid to retirees.
6. Portable pensions that vest after one year should be made available to that segment of the workforce whose jobs are often subject to intermittent lay-offs, unemployment, part-time employment and high mobility.

The NAACP Legal Defense and Educational Fund, Inc. (LDF) is a non-profit corporation organized to assist Black American citizens in securing their constitutional and civil rights. In April 1984, the Board of Directors of LDF approved for implementation the Black Women's Employment Program, a new project designed to address problems encountered by working poor Black women. The Black Women's Employment Program was developed in response to our long-standing concern about a growing permanent underclass that is disproportionately comprised of Black Americans, and about the increasing number of working Black single mothers and their children who are living in poverty. Since its inception, the Black Women's Employment Program has engaged in a variety of activities to improve the economic conditions of working poor Black women.

Although women as a group have made a number of gains in pension coverage, participation and benefit entitlement in recent years, much of which can be attributed to the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 and the Retirement Equity Act of 1984, further congressional action is required in order to achieve pension equity among all workers and to ensure adequate retirement income to the nation's workforce. LDF commends this Committee's efforts to redress some of the more serious inequities and inadequacies in the private pension system through Senate Bill 1784--the Retirement Income Policy Act of 1985 (the "Act").

LDF supports the policy goals of the Act to the extent that such policy goals increase worker coverage in private employer provided pension plans encourage growth and development of pension plans among all private employers, especially those who own small businesses; and assure adequate retirement income to the nation's retired workforce. However, the Act has both strengths and weaknesses as indicated by the testimony presented to this Committee on January 28, 1986 by Anne E. Moss of the Pension Rights Center, and Dr. Mary W. Gray of the Women's Equity Action League (WEAL). We refer this Committee to that testimony.

This written testimony will focus on how the most fundamental provisions of the Act--pension coverage, vesting, portability and integration--affects working poor Black women who will become a part of this country's retired workforce. Our testimony includes an overview of the precarious socio-economic status of working poor Black women so that the importance of pension benefits to these women is fully understood and appreciated. The jobs which Black women hold during their working years have a direct correlation to the kind and amount of retirement benefits they may receive, if any, on retirement. We also include recommendations that we believe will further redress the inequities that currently exist in this nation's private pension policy.

An Overview of Working Poor Black Women

1984, the poverty rate for Black Americans was 34 percent compared to 12 percent rate for White Americans.1/ This means that one of every three, or 9.5 million, Black Americans were living in poverty in 1984. 2/ The number of Blacks in poverty increased by nearly 2 million between 1978 and 1984. 3/ Families that are headed by a single woman are more than three times as likely to be poor than families headed by a married couple or a single man. 4/ However, families that are headed by a single Black woman are more than five times as likely to be poor. 5/ In 1984, 53 percent of all families headed by single Black women lived in poverty, 6/ even though the majority of these women were in the labor force. Approximately 63 percent of single Black women with children under 18 years of age were in the labor force, as were 70 percent of those with children between the ages of 6 and 17, and 57 percent of those with children under the age of six. 7/

The fact that many working Black women are poor can be attributed largely to inequities in their earnings, job status and job benefits--including those economic benefits provided by private employer pension plans. For instance, Black women who work full-time year round are paid approximately 56 cents for every dollar paid to White men. 8/ The earnings of almost 53 percent of Black women heads of households are at or below the poverty level. 9/ More than 70 percent of all Black women are employed in low-wage and low-status occupations--30 percent are employed in private household and service occupations (i.e., cleaning services, teacher aids, social worker aids and health service aids), while 30 percent work in low skill clerical jobs (i.e., file clerks, clerical assistants, typists, telephone operators and receptionists), 7 percent in nondurable goods as operatives, and 3 percent as retail sales workers.[10] As they reach what is romantically described as their "golden years" in life, many of these women will become a part of the elderly Black population who are now living in poverty.

Elderly Black Americans comprise more than 8 percent of all persons 65 years old and over in this country.[11] Approximately three out of every five (60.2 percent) elderly Blacks are women.[12] Elderly Black women who live alone or with nonrelatives comprise one of the nation's poorest groups.[13] In 1982, 80 percent of all elderly Black women living alone lived in poverty while only 49 percent of White women and 34 percent of White men were poor.[14] Throughout their lifetimes Black women continue to earn approximately half as much as White men. In 1982, the median annual income for single elderly Black women was $3,710 compared to $5,920 for White women, $4,660 for Black men, and $7,750 for White men.[15] The disparity was even greater between single elderly Black women and elderly married couples as elderly married Blacks and Whites had median annual incomes of $8,790 and $15,690, respectively.[16] The latest data available from the Social Security Administration reveals that the average annual Social Security benefit received by elderly Black women is $2,304 compared to $3,120 received by elderly White women.[17]

The Social Security benefits received by single elderly Black women are woefully inadequate to enable them to maintain a standard of living above poverty subsistence when such benefits are either their sole or primary source of support. Thirty percent of single elderly Black women depend on Social Security benefits for their entire income and 86 percent depend on such benefits for half or more of their income.[18] These facts clearly indicate that other sources of retirement income are required if an overwhelming majority of elderly Black women are to live out their remaining years in independence and dignity and not in abject poverty.

Many studies have concluded that certain job characteristics--the individual's occupation, length of employment service, and annual earnings--are the most important factors that determine whether or not an individual will be covered or recieve benefits under a private employer pension plan.[19] All of the studies indicate that Black workers are much less likely than White workers to possess those job characteristics that lead to a high probability of pension coverage: employment in manufacturing, or as a professional or technical worker; long employment service; and annual earnings of $15,00 or more. These studies show that Black workers tend to be employed more often than Whites in nonprofessional service occupations where private pension coverage plans are not common, they tend to have fewer years of employment service which prevents them from meeting vesting requirements even when an employer does provide a pension plan, and they tend to have lower annual earnings.[20] As more fully discussed below, Black women are particularly disadvantaged with respect to pension benefits provided by private employers since an overwhelming number work in nonprofessional occupations, have intermittent periods of employment service, and earn low- wages.

Only five percent of all elderly Black women (married and nonmarried) received income from a private employer pension plan in 1984, compared to 12 percent of all White women, 20 percent of all Black men, and 34 percent of all White men who were 65 years old and over.21/ The mean annual private pension income of elderly Black women was $1,641 compared to $2,478 for White women, $3,067 for Black men, and $4,624 for White men.22/ In 1982, only 22 percent of all Black women 55 years old and over had ever received income from any type of employer provided pension plan, whether public or private, compared to about 30 percent of Black men, 45 percent of White women and 50 percent of White men.23/ Obviously, Black women's receipt of benefits from pension plans is greatly disproportionate to their labor force participation.

In order to ensure that all workers have adequate income in their retirement, they must be afforded equal access to and participation in private employer pension plans. To achieve full pension equity among all workers, private employer pension plans must be provided by small employers as well as large employers, and pension coverage must extend to low-wage earners as well as to high-wage earners, part-time workers as well as full-time workers, and older workers as well as younger workers. In addition, vesting requirements must be made available to accommodate the intermittent work patterns of many Black women. The practice of integrating Social Security benefits and pension benefits should be abolished, however, short of this, the integration of such benefits should at least provide a minimum pension benefit amount that enables retirees to maintain a decent standard of living.

Pension Coverage

As recognized by the Act, nearly half of all workers in this country are not covered by any type of pension plan. The Act attempts to increase coverage by requiring all those employers who provide a pension plan for employees in a single line of business to include in a plan those employees who have earnings that are below the Social Security taxable wage base ($42,000). LDF supports this provision because it would eliminate the practice of excluding low-wage earners and workers in typically low-coverage occupations from participation in private pension plans. Although this provision would offer pension coverage to many low-wage Black women, the provision falls short of its policy goal of assuring adequate retirement income to all of the nation's workforce. The provision should extend coverage requirements to part-time workers who are employed at least 500 hours annually and to older workers.

Coverage for Low-Income

As previously discussed, many studies have shown that individuals who are employed in high-status and high-earning occupations in the private sector are much more likely to be covered by pensions and receive pension benefits than those individuals who work in low-status and low-wage jobs. For example, private pension coverage is highest in such high-wage industries as communications and public utilities where coverage is 82 percent, mining (69 percent), and manufacturing of durable goods (68 percent) and nondurable goods (61 percent).24/ Black women's employment in these high-wage industries, however, is quite low, and in some of these industries, many Black women are paid below poverty wages. For instance, only 3.7 percent of all Black women are employed in communications and public utilities (over 25 percent earn below poverty wages); only .12 percent are employed in mining; and 7 percent in nondurable goods manufacturing.25/

Black women are overrepresented in their employment in low-wage industries that typically do not provide pension coverage. Pension coverage is provided to 70 percent of workers who earn $15,000 or more yearly but coverage for workers who earn less than $10,000 in low-paid, high mobility service, labor and sales jobs ranges from 25 to 43 percent.26/ Annual full-time income for Black women service workers in 1982 was $8,204 and for clericals $11,348.27/ Sixty percent of all Black women workers are employed in clerical and service occupations.28/ The median annual income for full-time Black women workers was $11,161 compared to $21,036 for White men.29/ The expanded coverage proposed by the Act will benefit many Black women who earn low wages and who work in low-coverage occupations.

Part-time Workers

The disproportionate overrepresentation of Black women in part-time or intermittent employment in low-paying occupations greatly contributes to poverty among Black women. An average of 18 percent of all workers are employed part-time.30/ But in the occupational categories heavily occupied by Black women, part-time employment is much higher.[31] Fifty percent of all Black women work part-time, part-year, and the vast majority do so involuntarily.[32] The largest proportions of involuntary part-time workers may be found in the service occupations, among operators classified as handlers, and among retail sales workers.[33] Low-wage industries such as private households and personal services exhibit the highest involuntary part-time employment rates and tend to employ disproportionately large numbers of Black women.[34]

Part-time employment is rarely accompanied by such non-wage benefits as pensions and health insurance. In addition, many part-time jobs pay lower hourly wages than full-time employment even when the work is essentially equal.[35] The median annual income of Black women who work part-time in low-wage occupations is $2,775.[36] It is $3,213 for Black women who work part-time year round, and $6,179 for those who work full-time in such occupations.[37]

Some employers may offer part-time employment as an incentive for women who desire to work part-time and to spend more time with their families. Other employers may offer part-time employment so that they can avoid the increasing costs of seniority, advancement opportunities and employer provided non-wage benefits that accure to full-time workers.[38]

In order to ensure adequate retirement income for the great number of Black women who are employed part-time throughout their working lives, the Act must include a provison to require employers to offer pension benefits to those who work over 500 hours annually.

Older Workers

Many older Black women continue working or re-enter the labor force in their later years. Black women between the ages of 55 and 64 comprised 21 percent of all Black women employed as private household workers and 32 percent of all Black women employed as service workers in 1982.39/ Even after age 65 Black women's representation in household and service employment remains high: 41 percent of all Black women employed as private household workers were 65 and older; and 28 percent of all Black women employed as service workers were 65 and older. 40/ Almost half of all elderly Black women have incomes below the poverty level. 41/

Nearly 31 percent of all Black families are headed by a woman who is 55 or older. 42/ Families that are headed by older Black women are twice as likely to have children under 18 years of age than older White female headed families.43/ Older Black women have a higher probability than White women of being displaced homemakers either due to the death of their spouse or to divorce, and many of these women enter or re-enter the workforce in their later years in order to support themselves and their families. 44/ These women are typically too young for Social Secuirty and sometimes too old to participate in private employer pension plans. The Act's pension coverage provision must be extended to prohibit private employers from excluding from coverage individuals who start employment at 65 years of age or who begin their employment within five years of the plan's retirement age.

Vesting of Pension Benefits

The Act proposes to reduce requirements for the vesting of pension benefits from ten to five years in all private employer provided pension plans, with the exception of those provided by multiemployers. LDF supports the proposed reduced vesting requirements because few Black women are ever able to meet the current ten year requirment due to the high rates of part-time employment, unemployment and high mobility that are associated with the jobs that most Black women occupy. However, we strongly believe that the five year vesting requirement should apply to pension plans provided by multiemployers and to part-time workers who work 500 hours or more annually so that full pension equity among all workers is achieved. Workers should not be penalized because they work part-time or because they work for an employer who is a part of a multiemployer pension plan. We thus recommend that this Committee consider extending this reduced vesting requirement to apply to multiemployer pension plans and to part-time workers who are employed more than 500 hours annually.

Portability of Pensions

The provisions in the Act governing the portability of vested pensions must be extended to address the important needs of many Black women who have intermittent work histories. Intermittent employment patterns may reflect personal choices but among Black women, it is much more likely to be caused by the fluctuating nature of the occupation or industry in which they are is employed. As a result, many Black women never acquire enough tenure in their job for their pension benefits to vest and any benefits that may have accrued are forfeited when separation from employment occurs.

LDF recommends that private employers be required to provide pension benefits to all workers, including those who work part-time and in low-wage occupations, and that vesting requirements of no more than one year be established for those industries that are subject to intermittent employment patterns.

Truly portable pensions would allow workers to have any employer pension contributions that they have accrued among their various employers placed in an individual retirement account so that they can provide adequately for themselves upon retirement. These suggested changes to the proposed Act would greatly improve the economic status of many Black women and in the future serve to prevent disproportionate numbers of older and elderly retired Black women workers from living in poverty.

Integration

Under current law, the system of integration of Social Security and pension benefits has often eliminated pension contributions or benefits for lower paid workers while benefitting higher paid workers. The Act proposes to eliminate this patently unfair result by requiring employers to provide the vested retiree with at least 50 percent of the contribution or benefit amount that would have been paid without integration. Although this is an improvement over existing law, LDF believes integration should be entirely eliminated. At the very least, however, the Act should establish a required minimum pension benefit amount to be paid to retirees that would ensure an adequate retirement income--particularly for those with long histories of inadequate wages.

Also, integration formulae should be simplified and employers should be required to explain the effects of their particular formula to their employees. LDF recommends that this Committee more fully study the whole issue of integration and how specific integration formulae affect different workers at various income levels. Any formula that is adopted ought to be related to the average earnings of workers as a whole and be designed to improve the retirement earnings of all workers rather than focusing only on replacing the high wages of higher paid workers at the expense of lower paid workers.

STATEMENT OF
THE NATIONAL EMPLOYEE
BENEFITS INSTITUTE

I. INTRODUCTION

The National Employee Benefits Institute ("NEBI") is an organization composed of Fortune 1000-size companies which share a common interest in legislation and regulations impacting benefit planning. NEBI represents $100 billion in pension assets, and its members employ hundreds of thousands of workers who are covered by many types of benefit programs.

NEBI wishes to thank the sponsors of the Retirement Income Policy Act ("RIPA") for presenting the first major piece of pension legislation in history to reflect a concern for the need for a comprehensive pension policy; an awareness of the important relationship among private pensions, Social Security and personal savings (the "three-legged stool"); and a sensitivity to the administrative burden and expenses related to frequent, piecemeal legislation. NEBI wholeheartedly approves of the deliberate, reasoned method by which this bill was conceived and drafted. This organization has long advocated a national retirement policy which achieves an appropriate balance between participant safeguards, administrative practicalities and national retirement income goals.

II. RIPA'S CONTRIBUTION TO A NATIONAL RETIREMENT POLICY

We commend the RIPA sponsors and their staff for incorporating a delayed effective date for the bill. This particular provision allows both plan sponsors and participants to regard their retirement plans with some sense of predictability and stability. Since the enactment of ERISA in 1974, major legislation in the retirement area has required frequent plan amendments. TEFRA, DEFRA and REA, all effective between 1983 and 1985, mandated particularly complicated and extensive changes. As a result, many employers, particularly smaller ones, felt forced to terminate plans rather than to comply. Perhaps the possibility of more sweeping "reforms" contributed to the abandonment of many plans.

For former participants in terminated plans, or those for whom plans have not been made available, it is difficult to argue that this frequent legislation has been of benefit. A system less prone to change is more likely to result in more American workers coming under the protective umbrella of the private sector retirement security system than is a rash of new law.

In the same vein, NEBI applauds the overall RIPA focus on retirement rather than fiscal policy. NEBI opposes legislation in the employee benefits area which is primarily intended to help implement goals of reduced deficits, tax simplification or other nonretirement policy concerns. When legislation is proposed in a policy vacuum, as has been the case with tax reform proposals from both Capitol Hill and the White House, the viability of the "three-legged stool" is ultimately at stake. Historically, public benefit programs have assumed the continued existence and vitality of private ones and vice versa. The retirement security of millions of American workers and their families cannot hinge on whether employee benefits are considered to be a point of least resistance for tax reform.

III. COMMENTS ON SPECIFIC RIPA PROVISIONS

While the need for predictability and stability is expressed in the proposed legislation, certain provisions of the bill either vary from this ideal, or otherwise are counterproductive to the national retirement system.

A. Coverage and Benefits.

NEBI endorses the RIPA goal of increasing the coverage of private retirement plans but questions RIPA's methodology.

1. RIPA would require that all employees earning below the Social Security wage base who meet current age and service requirements would have to be covered by a company's retirement plan. Requiring coverage of virtually 100% of all workers earning below the Social Security wage base (94% of all American workers) could hurt companies which already cover a substantial nondiscriminatory percentage of their work forces without addressing the real issue: the relatively low plan coverage levels among small companies.

According to a study performed by the Employee Benefits Research Institute (EBRI), an increase in coverage among small (less than 100 employees) companies to the level provided by larger companies would result in 7.6 million additional workers being covered by a private retirement plan. The RIPA coverage provision does not give recognition to the fact that there are many reasons why nondiscriminatory plans must be tailored to cover particular employee groups in somewhat different ways. Market forces, employee relations and the Internal Revenue Code's very comprehensive nondiscrimination rules essentially guarantee fairness in plan coverage.

NEBI believes that a policy solution should be sought which encourages smaller companies to adopt and maintain a qualified retirement plan. Our members do not believe that the proposed coverage rules would accomplish a significant increase in coverage and could, in fact, lead to more plan terminations and an overall coverage decrease.

2. RIPA proposes that contribution and benefit limits be tied to the Social Security wage base. The benefit limit for a defined benefit plan would be 200% of the current wage base; the defined contribution plan limit would be 50% of the wage base.

Internal Revenue Code section 415 limits have been decreased and frozen over recent years. Many analysts believe that the arbitrariness of these changes has hurt most the employees intended to be benefitted: lower paid workers. Those who have favored lower overall limits fail to recognize that if qualified plans cannot provide a meaningful replacement level income for upper management, a company may terminate qualified plans and replace them with discriminatory nonqualified plans providing little or no benefit for the rank and file. Alternatively, benefits may be reduced across the board to match the maximum possible for the top executives in the plan.

While allowing benefits and contributions to adjust to economic realities in a systematic way is welcomed by many in the employee benefits community, NEBI objects to the defined contribution multiple which would, based on the 1986 wage base of $42,000, restrict defined contribution plan contributions to $21,000. This figure is $4,000 less than the original ERISA limit of $25,000 in 1974. In view of both the increase in the overall cost of living since that time and the increased reliance on defined contribution plans as retirement income vehicles, the proposed formula seems fundamentally unfair. NEBI would prefer to see a formula which would yield a limit at least comparable to the current maximum.

B. Retirement Versus Nonretirement Plans.

NEBI companies believe that retirement plans should provide retirement dollars. NEBI agrees with the RIPA sponsors' belief that retirement dollars should not easily be diverted for nonretirement purposes.

1. RIPA would require a distinction to be drawn between "retirement" and "nonretirement" plans. Employees could make tax deferred contributions only to retirement plans which would be subject to severe payout restrictions. NEBI disagrees with the plan distinctions created by RIPA on two

bases: first, NEBI members find the criteria for drawing the distinction confusing and restrictive; second, NEBI members generally oppose any proposal which discourages participant savings. The personal saving rate in this country is approximately 1/3 that of most industrialized countries in the world. The increasingly popular 401(k) plan reflected a recognition that, given the proper incentive (tax deferred contributions and tax deferred earnings) American workers would adopt a more aggressive savings posture. While 401(k) plans, like any qualified plan, are first and foremost a retirement device, worker-contributors, especially younger ones, are more comfortable with long term savings through salary reduction if given an escape hatch. The Internal Revenue Service has provided some fairly rigid hardship withdrawal rules which a plan may or may not include as an option. Among our member companies which do permit such hardship withdrawals, there is agreement that employees generally respect the restrictions and a relatively small number of withdrawals are made. These plans simply are not viewed as pre-retirement capital accumulation plans.

Section 401(k) plans now cover more than 20 million employees. Lower paid workers (who a recent EBRI study show are three times more likely to participate in a 401(k) plan than to contribute to an IRA) will be hurt by further 401(k) restrictions. Workers nearing retirement especially deserve to be able to depend on contribution limits relied upon for retirement planning. The 401(k) plan was a sound idea: encourage individual participation in retirement savings and give companies a low-cost retirement plan alternative. It is no less sound because of its widespread success.

2. RIPA would restrict distribution from a retirement plan to an annuity or similar periodic payment form. It is a suspect policy which permits no diversion, no variation, no individuality. Our retirement distribution rules--allowing plans to permit selection among various options including annuities, lump sum or periodic payments--indicates our respect for the decision-making powers of mature Americans. Paying off a mortgage, buying a retirement home or managing the investment of the retirement nest-egg may be the most appropriate choice for some individuals. Restricting all distributions to retirement annuities is an unnecessary intrusion into an individual's retirement planning. NEBI does not believe that there is a sound policy justification for this particular proposal.

3. RIPA would forbid plan distributions before age 59-1/2 unless the participant died or became disabled. IRA rollovers and plan to plan transfers would be permitted. NEBI disapproves of legislation which would prohibit early

distribution to other than an IRA rollover or transfer to another qualified plan. Employees do not routinely leave secure employment in order to abuse a retirement plan distribution. Some individuals separate from service and choose an alternate investment vehicle (such as investing in a new tax-paying business venture) which may be of substantial benefit to the community.

C. Vesting.

RIPA would require a single employer plan benefit to become 100% vested no later than the end of the fifth year of vesting service. RIPA sponsors and NEBI employers favor a goal of having more workers reach retirement age with a vested pension. It is this organization's view that reducing the maximum vesting period to five years is unlikely to make a meaningful contribution to that goal.

Most employment turnover occurs among younger age groups. Due to lower overall income levels, defined contribution account balances are relatively small. Defined benefit plan formulae typically result in a minimal retirement benefit accruing in these early, lower income years. While in the aggregate forfeited benefits attributable to rapid turnover among younger workers may help defray a certain amount of retirement plan expense, the individual young worker would realize little gain from this proposed vesting change. Defined benefit plans, particularly, are weighted to favor the long term employee who retires with the company. NEBI believes that employment stability and longevity is itself a worthwhile goal. Further, the added administrative expense of maintaining these minimal benefits, perhaps for decades, could be unduly burdensome for some employers. Alternatively, under current law minimal benefits could be involuntarily cashed-out, nullifying the retirement benefit aim of this provision.

Putting all of these various factors in the balance, this organization doe not believe that five-year vesting makes a significant contribution to the country's overall retirement policy goals.

D. Elimination of 10 Year Forward Averaging and Capital Gains Treatment of Plan Distributions.

Plan participants approach their nonemployment years with certain expectations. Many have calculated their future incomes and planned personal savings programs in anticipation of certain levels of income from profit sharing and savings plans. Taxing these distributions at ordinary income rates could drastically impact careful retirement planning. When funds are committed to retirement plans, their ultimate tax liability should reflect the reasonable expectations of the company and participant at the time contributions are made. To change the rules midstream could unfairly subject a rank and file employee to an unexpected, significant reduction of retirement income.

IV. CONCLUSION

NEBI regards RIPA as a landmark bill. As the first piece of proposed legislation to enunciate a concern for retirement policy, it is worthy of careful regard by the full Congress, business and labor. NEBI believes that a cost-benefit analysis of some of the RIPA provisions discussed in this testimony will indicate that some alternate solutions need to be examined. In general, NEBI favors an overall approach to employee benefits legislation which provides strong employer incentives to implement and maintain qualified retirement plans. Absent a focus on positive encouragement, the number of employees who can look forward to a secure, dignified retirement may never significantly increase. NEBI employers hope that this kind of future will become a reality for all working Americans, and that private sector retirement plans will always participate in the fulfillment of that promise.

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KENNETH HANDY
Director of Financial Services

February 11, 1986

The Honorable Bob Packwood
Chairman
Committee on Finance
U.S. Senate
Room 219, Dirksen Building
Washington, D.C. 20510

Retirement Income Policy Act of 1985, S.1784

Dear Mr. Chairman:

This is a statement for the record in connection with the hearings of the Committee on Finance on the Retirement Income Policy Act of 1985, S.1784. This statement is made on behalf of The Permanente Medical Group, Inc. ("TPMG"). TPMG provides medical services in Northern California to members of Kaiser Foundation Health Plan, Inc. We believe that TPMG is the country's largest professional corporation, with over 1600 physician-shareholders. TPMG provides medical care to approximately 2,000,000 people in 14 counties in Northern California. Nationwide, the Kaiser Permanente Medical Care Program provides health care to about 4,800,000 people in 13 States and the District of Columbia. TPMG provides substantial retirement benefits to its employees.

SUMMARY

TPMG supports the Retirement Income Policy Act except in five respects. The exceptions are as follows:

KAISER PERMANENTE

(1) The coverage provisions of the bill have substantial flaws. TPMG suggests that the bill be changed as follows: (a) the existing 70% coverage rule is retained; (b) the existing facts and circumstances rule is eliminated; (c) at least 2/3s of the employees not covered under the 70% rule (except for collectively bargained employees, and employees who do not meet age or service requirements) must receive minimum nonintegrated retirement income benefits of 1/2 of 1% times average high 5 years compensation times years of service under a DB plan or contributions of 3% of compensation under a DC plan.

In addition, TPMG proposes that the definition of collectively bargained employees be clarified for coverage purposes so these employees include "union tag alongs." This should only be done with safeguards to prevent abuse, including providing tag along with the minimum benefits described above.

(2) The proposed vesting change, requiring 100% vesting after 5 years, will cause substantial disruption for many retirement plans. (This is clear from the exception in the bill that allows 10-year vesting for multiemployer plans.) However, if 5-year vesting were required for DC plans only, less disruption would occur, and employees' expectations would be more closely met. Therefore, TPMG proposes that 5-year/100% vesting be the minimum for DC plans and that 10-year/100% vesting be the minimum for all DB plans, not just multiemployer plans.

(3) The coverage rule allowing 3 years of service with 100% vesting should be retained to encourage faster vesting and allow employers to reduce administrative costs.

(4) The dollar cap proposed for 401(k) plans is bad retirement income policy and will bring perverse results, including eliminating funding protection for the retirement income of many employees and encouraging individual professional corporations. TPMG proposes that instead of a dollar cap, the bill modify the nondiscrimination rules of present law to set a maximum deferral percentage per participant of two times the average deferral percentage of the lower 2/3s of participants. This will eliminate undue discrimination and allow needed "catch up."

(5) TPMG believes that the goals of eliminating special tax treatment for lump sum distributions are proper but cannot support this provision of the bill because it will operate regressively to the detriment of the lower paid. TPMG would support this change if the lower paid were protected.

BACKGROUND - TPMG's RETIREMENT PROGRAM

TPMG has over 11,000 employees and provides substantial retirement programs for them. About 8,000 of TPMG's employees are covered by collectively bargained agreements, and their benefits are set by these agreements. The rest of TPMG's employees are provided with defined benefit and defined contribution plans, once they qualify under the applicable statutory and plan rules. Only one of TPMG's plans is integrated with Social Security. The only integrated plan maintained by TPMG is one collectively bargained plan where the union has refused TPMG's requests to eliminate integration.

TPMG's defined benefit plans for physicians and non-union non-physicians are almost the same, though not identical. These plans provide a benefit based on final average pay and have 10-year "cliff" vesting. Participants in both these plans generally can earn a pension of 50% of final average pay.

TPMG's defined contribution plans are more diverse. Non-union non-physicians have both a money purchase plan and a 401(k) plan; the physicians have only a 401(k) plan. Under the non-physicians' money purchase plan, participants set aside 2% of after-tax compensation and receive an employer contribution of 5% of compensation. Neither of the 401(k) plans provides for employer contributions; both operate on a salary reduction basis only. In this respect, the non-physicians receive more of a "real" employer contribution (that is, no salary reduction) than do the physicians.

TPMG SUPPORTS ALL BUT FIVE OF THE PROPOSALS IN S.1784

The proposals in S.1784 are wide ranging, with many details. TPMG supports the following:

1. Findings and Declaration of Policy.

TPMG supports the Findings and Declaration of Policy, with the following modifications: (a) employer financed retirement plans are of equal importance to Social Security benefits; (b) individual savings for retirement through employer sponsored, nondiscriminatory plans should be strongly encouraged for providing retirement income; (c) inflation must not be allowed to erode the real level of retirement benefits and therefore any dollar limits on retirement benefits that are established by law must be adjusted for increases in the cost of living; and (d) the health of the retirement system requires stability in its governing rules and the Congress will provide such stability with this Act.

2. "Retirement Plans"

TPMG supports the bill concerning "retirement plans" and: restrictions on the time of distributions, restrictions on benefit forms (except as described below), and direct transfers from plans. This support is explicitly conditioned on the ability of a plan to transfer to an IRA or other retirement plan the vested benefits of terminated employees.

TPMG also supports requiring a minimum level of benefits under a "retirement plan" before the employer can maintain a "nonretirement savings plan" (that is, 1/2 of 1% per year of service times average high 3 years' compensation for DB plans or a 3% contribution for DC plans).

TPMG suggests that lump sum distributions and annuities with "period certain" features be allowed from "retirement plans." If these distributions are prohibited, the Congress will be substituting its judgment for the judgment of individuals on the best use of their own retirement income, and this is inappropriate under our system of government. For example, it is not appropriate for the Congress to decide that an individual should not purchase a retirement home or pay off a mortgage with a lump sum payment from his or her retirement plan. It also is not appropriate to prevent an employee from receiving an annuity with, e.g., a 10 year period certain feature to ensure that his or her child is guaranteed sufficient income to complete school.

3. Limits on Benefits

TPMG supports the bill concerning limitations on contributions and benefits. Specifically, TPMG supports making the DB dollar limit two times the Social Security wage base, making the dollar limit for DC plans one-half of the wage base, making the percentage limit for DC plans 20% of compensation, and limiting compensation to be taken into account for benefits and contributions to five times the wage base.

In addition, TPMG strongly supports the elimination of the combined plan limit of section 415(e), for all plans except top heavy plans. TPMG's experience is that these limits do not work. It is very difficult to obtain the needed information and make the calculations that are necessary to apply the limits and it is extremely difficult to explain the limits to affected participants. TPMG recognizes that there are revenue constraints involved in eliminating the combined plan limits. For this reason, TPMG previously has proposed that, to the extent necessary to achieve revenue neutrality, the dollar limits be reduced in order to eliminate the combined plan limits of section 415(e).

4. Integration with Social Security

TPMG supports the integration proposals of the bill.

5. Coverage and Portability

TPMG supports the provisions of the bill that allow a plan (after a participant's retirement or termination and subject to the notice and election rules of existing law) to make a direct transfer, after notice to the participant or beneficiary, to an IRA designated by the participant (or, when there is no designation, to an IRA selected by the plan).

THE BILL'S COVERAGE RULES HAVE SERIOUS FLAWS. TPMG SUGGESTS THAT THEY BE CHANGED TO REACH APPROPRIATE RESULTS.

The bill is unclear in its coverage proposals. It appears that the bill may require that 100% of relevant employees with earnings less than the Social Security wage base be covered with a retirement plan, except to the extent that the "subdivision" rules operate. If those rules operate, then apparently 100% of relevant employees who earn less than the wage base and who work at each subdivision with a plan must be covered and 80% of "all" employees of the employer who earn less than the wage base must be covered.

This proposal has substantial flaws. First, under current law there are two tests, the "objective" test requiring 70% coverage of "all" employees (and the 80% of 70% test) and the "facts and circumstances" test. There has been substantial criticism of the facts and circumstances test because it is difficult to administer and therefore creates unfair results. There has been no such criticism of the 70% objective test. Therefore, by eliminating the 70% test, the proposal is overbroad and would disrupt many established programs that provide benefits to a broad base of employees and also give employers needed flexibility.

Second, the bill allows less than 100% coverage for employees earning below the wage base only when the employer has separate facilities or other subdivisions, and this could provide competitive advantages to some employers.

Third, it is unclear what benefits must be provided under the bill to those covered. There is no mention of "comparability" as currently required under the tax laws nor is there a requirement of a minimum level of benefits.

To correct these flaws, the bill should be changed, as follows:

1. Retain the overall 70% coverage test of present law.

2. Eliminate the facts and circumstances test of present law.

3. For 2/3s of the employees who are not within the 70% covered (under (1) above), require a minimum benefit if the minimum age and service rules are met and the employees are not collectively bargained. The minimum benefit would be: for a DB plan, 1/2 of 1% per year of service times high 5 years average compensation; for a DC plan, a contribution of 3% of compensation.

In addition, the bill should clarify the definition of collectively bargained employees for coverage purposes. In excluding bargaining unit employees from the nondiscrimination tests, present law recognizes that an employer does not always unilaterally determine the form of compensation for its employees. In many cases, hourly employees who are not in a bargaining unit are treated exactly like union employees for benefits and have essentially the same benefit plans. Their benefits are in fact controlled by bargaining because the employer must maintain compensation parity.

Since the employer is in fact precluded from giving these "tag along" hourly employees different benefits from the union employees, they should be treated in the same way as union employees under the coverage rules. However, to prevent abuse, the tag along rules should be limited to situations where the tag alongs are not more than 100% of the collectively bargained group and where the tag alongs receive the minimum benefits suggested above (1/2 of 1% per year of service times average high 5 years compensation in a DB plan or a 3% contribution under a DC plan). Employees would be tag alongs if eligibility, vesting and benefits for them were changed within a year after bargaining unit changes and if health and life benefits follow the same pattern. (More than one bargaining unit covered by a single plan would be treated as a single unit; separate groups of tag alongs could follow separate bargaining units.) To prevent abuse, nonunion hourlys who are not tag alongs on January 1, 1986 would be so treated only with an IRS finding that the arrangement did not have as one of its major purposes obtaining the benefits of the exclusion.

THE 5 YEAR VESTING PROPOSAL SHOULD BE MODIFIED, PROVIDING 5-YEAR/100% VESTING FOR DC PLANS AND 10-YEAR/100% VESTING FOR DB PLANS.

The bill would establish minimum 5-year cliff vesting for all plans except multiemployer plans. This proposal would cause major disruption for many defined benefit plans that now have 10-year cliff vesting and would not fit with the expectations of many employees.

The fact that the bill has an exception to the 5-year rule for multiemployer plans, allowing 10-year cliff vesting for these plans, demonstrates clearly that a 5-year rule would cause major disruption. While 10 years is proposed for multiemployer plans, 10 years is the standard for many plans, whether or not multiemployer. (There is no special magic to a multiemployer plan. Even though it covers employees who work in an industry rather than for a single employer, employees can shift between covered and noncovered employers in an industry and need vesting protection. If this were not the case, ERISA would not have required the same minimum vesting for multiemployer plans as for all other plans.) Plans have 10-year vesting for several reasons: faster vesting could substantially increase the cost of benefits paid, or lead to a reduction in the level of benefits paid, on retirement. Also, faster vesting does not fit with many employees' expectations concerning DB plans; many employees expect that to obtain a retirement income for life they must, on their part, provide services to an employer for a significant period. There is a basic fairness here -- long-term retirement income in exchange for long-term service.

The facts and expectations are different for DC plans. Both employers and employees view these plans more as providing current compensation, although deferred in payment. Therefore, vesting for DC plans often is faster than 10-year cliff and employees fairly expect such faster vesting.

In these circumstances, to require 5-year vesting for DB plans would be inappropriate. Instead, 10-year cliff vesting should become the minimum standard for all DB plans, not just multiemployer plans, eliminating 5-15 year graded vesting and eliminating the rule of 45. In addition, it would be appropriate to require minimum 5-year cliff vesting for DC plans.

THE EXISTING RULE ALLOWING 3 YEARS OF SERVICE WITH 100% VESTING SHOULD BE RETAINED.

The bill would eliminate the 3-years-of-service/100% vesting rule. This would hurt both employees and employers and should be eliminated from the bill.

The 3 years of service/100% vesting rule helps employees. Even if 5 year/100% vesting were enacted, many employees would be better off if they could vest totally after 3 years, and this vesting should be encouraged. In addition, the 3-year/100% vesting rule benefits employers. This rule reduces the administrative costs of employers who experience high turnover in the first 3 years of employment. Therefore, the existing rule benefits both employees and employers and should be retained.

THE DOLLAR CAP FOR 401(k) PLANS IS BAD RETIREMENT INCOME POLICY. IT SHOULD BE REPLACED WITH NEW NONDISCRIMINATION RULES.

The proposed dollar cap on 401(k) contributions is bad retirement income policy because it will bring perverse results.

Corporations will not eliminate elective deferral programs because of the dollar cap, but instead will broaden nonqualified, unfunded programs to include more management employees, who will be the ones affected by the cap as a practical matter. Amounts deferred by these employees will be held by the employer as part of its general assets, and therefore this retirement income will be unfunded. This is a significant step backward from the policy established by ERISA to encourage funding to secure retirement income.

In addition, a cap on elective deferrals will encourage individual incorporation of professionals. Many professional partnerships and corporations allow individual corporate partners or shareholders. (TPMG does not.) TEFRA went a long way to eliminate these individual corporations by eliminating the disparity in benefits between incorporated and unincorporated individuals. With incorporation comes flexibility in plan contributions; therefore, incorporation will again be encouraged.

Furthermore, incorporation will be encouraged for those professionals who do NOT want to contribute to plans. If a cap on elective deferrals is enacted, to provide maximum contributions under a plan, employers will establish plans with high fixed contribution formulas. This will, in effect, require set asides from amounts now paid as compensation to those who elect not to defer. Maximum set asides often is what the majority of professionals want. But this, in turn will encourage individual incorporation, to obtain the flexibility not to contribute. This is a perverse situation -- to obtain current income, and pay taxes on that income, professionals will be forced to incorporate.

If a cap is included in the bill, at the minimum employees should be able to elect not to have the plan's formula contribution made for them, and this election should be available on a year-by-year basis.

But a dollar cap is the wrong policy, in any event. The issue with 401(k) plans is not the dollar amount set aside on a voluntary basis, but is instead the undue discrimination that can occur under such plans under current law. Under present rules, which test average deferrals, employees can "leverage off the zeroes." For example, if the average deferral percentage (ADP) for the top one-third must be 6% with two employees who contribute nothing, a third employee can contribute 18% so the average for the three is 6%. This disparity should be fixed.

However, the use of averages also fulfils another function: it allows employees to "catch up" and make larger retirement plan contributions in years when they have the available resources to offset years when they were not able to set aside for retirement. The need for catch up is recognized widely, including in the President's Proposals for Tax Reform (p. 365).

TPMG believes that both reasonable catch up and curbing undue discrimination can be achieved in a very simple way. A new limit, a maximum deferral percentage, could be enacted. This limit should apply to all plan participants, and it should be two times the ADP of the bottom two-thirds of the plan participants. This will allow needed catch up and will also prevent the undue discrimination that now exists.

TPMG BELIEVES THAT THE REASON FOR ENDING SPECIAL TAX TREATMENT OF LUMP SUM DISTRIBUTIONS IS APPROPRIATE BUT TPMG CANNOT SUPPORT THE PROPOSED CHANGE BECAUSE IT IS REGRESSIVE. THEREFORE TPMG SUGGESTS CHANGES IN THE PROPOSAL.

The reason for the proposal to eliminate special tax treatment for lump sum distributions is to encourage retirement saving. TPMG strongly supports this encouragement. However, TPMG cannot support the proposal to eliminate special lump sum treatment because it is regressive. Over 85% of TPMG rank-and-file plan participants take lump sums when they terminate employment (on or before retirement). The average distribution for hourly employees is about $17,000. The average distribution for non-physician salaried is about $50,000. Thus, the effect of elimination of the special tax treatment would fall most heavily on the lower paid. In addition, these people generally have the most difficulty understanding the complexities of a rollover IRS.

Because the lower paid will be most hurt by the proposal, TPMG cannot support it. However, TPMG could support a proposal that limits the benefit of special lump sum treatment to rank-and-file participants. In this way, the lower paid would be protected.

CONCLUSION

TPMG believes that, to a large extent, S.1784 is good policy and should be enacted. However, as described above, important changes should be made for the bill to operate properly.

Respectfully submitted,

THE PERMANENTE MEDICAL GROUP, INC.

By Kenneth Handy

Kenneth P. Handy
Director of Financial Services

STATEMENT
ON
PENSION REFORM
for submission to the
SENATE FINANCE COMMITTEE
by
Steven N. Schrenzel*
February 10, 1986

As you begin deliberations on this exceptionally important issue I would like to share some thoughts with you related to your endeavor.

By way of background, I am currently Director, Corporate Benefits of The Rockefeller Group, Inc., a diversified private company with employees in over 50 locations in every part of the country. Previously, I was manager of benefits planning for a Dallas based conglomerate with over 50,000 employees and retirees nationwide. Prior to that I was a consultant to industry and government in a wide range of human resources areas. I also serve on the Employee Benefits Council of the U.S. Chamber of Commerce and I am actively involved with several other major industry organizations. I have been frequently called on by various members and their staffs, as well as staffers who were participants in the work of the Presidential Committee on Pension Policy, for advice on prevailing practices, opportunities or problems.

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*Steven N. Schrenzel
Director, Corporate Benefits, The Rockefeller Group, Inc. as a private citizen.

In the spirit of not forgetting many of the lessons learned, I submit the following to you for consideration. These comments are submitted as my own opinion and not as a representative of my firm or any other organization.

During the Carter administration the Presidential Commission on Pension Policy (PCPP) attempted to discuss a national retirement income policy. The consensus of those of us who participated in that process was in fact that we had a national retirement income policy based upon the efforts of individuals, corporation sponsored retirement programs and government programs. While we certainly identified significant issues and I do not believe that any industry group endorsed the findings of the commission, I believe we thought we had a rational framework which, in addition to ERISA, could be fine-tuned as necessary.

Reopening the debate on retirement income policy at this point needs to include a number of significant issues. I would like to recommend consideration of the following issues:

First, consistency cannot be ignored. We have suffered through an era in which, since 1974, we have had over 15 major pieces of legislation that have impacted retirement income plans (see attached). As a result of the tax reform debate of 1985 we have a final product of the House, HR 3838, which may result in significant new curtailments in the benefits that can be provided by retirement income plans. Those of us who are practitioners in the field are very much aware of the trickle down effect. Corporate decision makers and entrepreneurs make decisions based heavily upon their own needs and desires. Human behavior in business is largely rational. At a time in which we are experiencing legislative curtailment on a recurrent basis it seems inconsistent with encouragement of the formation of these plans to continue such curtailment on benefits available to decision makers. The approach to IRC Sec. 415 imposed limits as described by S 1784 seems very reasonable and with moderate adjustment may provide needed consistency on an area of vital interest to corporate policy makers.

We also must be aware of relationship issues. By that I mean the relationship that a company should be expected to have with its workers or former workers. Some of the more extreme proposals suggest that it is appropriate for workers to vest in retirement income benefits with as little as five years of service. This would mean that if an employee starts service at age 18, as early as age 23 the employee would be vested in a benefit which might not commence until age 65 or 42 years later. The payout period can easily extend the relationship an additional 15-30 years. Many businesses do not survive for 40 or 50 years and the necessity of an individual to maintain a relationship with a former employer for that type of extended time period seems totally inappropriate.

Unless we are also proposing that all employees must have distributions of their vested benefits at the time they terminate employment it seems totally unreasonable to expect a company to have a permanent relationship with an employee who worked for that company for 1/9 or less of a normal career expectancy, especially at such a far point from their retirement date. The expense and administrative burden on employers in complying with this are also not insignificant. Additionally, many employees who would not be motivated by the prevailing practice of a ten year hurdle would be motivated by the hurdle of a five year vesting period and would take advantage of this. This could result in decisions to stay with a particular employer which are not in the best interest of employees or employer.

A radical acceleration of vesting without regard to the stage of life of the employee opens the door to political pressure for further reductions to 3 year, 1 year, or even immediate vesting. While these outcomes are not inherently bad, the likely result is a cutback elsewhere in plan design that will result in long service employees being the ultimate losers. I urge great caution in tampering with vesting provisions.

The vesting issue leads to a secondary issue, which is choice. In many cases employees make rational decisions between current pay and deferred pay. Retirement income is clearly nothing more than deferred pay. The combined effect for a 40 year service employee at retirement age of 65, from an employer's contribution to Social Security at the current level of approximately 7%, and a contribution of a similar level to a qualified pension plan, will produce a final average pay for an employee retiring with approximately $35,000 annual salary of over 75% of final pay. (The distinction between defined benefit and defined contribution plans is ignored here).

An individual in the labor market who is concerned about high wages does not necessarily need to develop the skills to seek out employment in an industry that typically provides high deferred pay or pension benefits. Typically, agriculture and service businesses, as well as small ventures and start-up businesses, pay high current wages relative to their corporate earnings, but do not provide deferred pay. On the other hand, if the worker is concerned about deferred pay he would want to develop the skills to participate in a business in which deferred pay is the norm. The manufacturing, transportation, and finance sectors are examples of this. The point of this is that individuals have the ability to vote with their feet in the labor market. Where arguments certainly can be made that the labor market is not perfect, and individuals may have limited options, we have established a system in which an individual's options are totally a matter of free choice based upon the information available to the individual.

S 1784 does nothing to address the issue of the marginal worker or the marginal employer. The individual who works intermittently or itinerantly will not gain as a result of this bill, while smaller successful businesses which have previously not installed plans may in fact be encouraged to do so as a result of this bill. I would argue that they can do so now with such simplicity that the objection of administrative burden is a red herring for lack of desire by the owners. The bill will do nothing to encourage marginal businesses, which often employ the least employable workers, to provide pension coverage.

Mandate versus reality is another issue to be considered. At present we are concerned about changing demographics in this country. We are also clearly in an environment of changing technologies. Most traditional forms of defined benefit pension plans have a significantly higher cost for individuals who are at a later stage in their career than for individuals who are at an earlier stage. Proximity to retirement is the primary reason for this. If we begin to mandate benefits, or if we begin to mandate new minimums, such as accelerated vesting, it is clear that we will continue to foster the perception amongst business people that older workers are more expensive. Companies will tend to be more selective in their hiring practices and those companies that can afford to offer both high current wages as well as deferred pay because of their competitive advantage will be able to develop the most sophisticated human resources, while emerging companies and companies in troubled industries will develop a less productive work force within their economic means.

The life cycle of a business is also an important element. Businesses in the venture or entrepreneurial stage are unlikely to be willing to divert resources necessary to grow their business into a pension trust which is, from a corporate standpoint, a less productive use of those assets. In times of high borrowing cost and rapid growth this could be devastating to those businesses. Similarly, companies fighting for survival may find maintaining a retirement income plan to be an intolerable burden. This leads to the related area of competitive pressures. We are clearly a global economy. Most other countries who currently enjoy a competitive advantage with our basic industries have far lower labor costs as well as a higher level of labor productivity. Their labor costs are lower both in a direct and indirect sense. Labor in our country has been unwilling to accept the wages and life-style that labor in other countries has been willing to accept in order to develop a competitive advantage. The effects of increasing employment cost cannot be ignored.

Another major issue in pension planning is portability. Portability is no longer a real issue since we have established an IRA roll-over as a viable vehicle whereby individuals can maintain the tax favored status of their retirement capital if in fact they should receive a lump sum. We have ensured through the PBGC that defined benefit plans, even if a company goes out of existence, will not be raided in such a way that a floor of promised benefits will not be paid. Those workers not participating in a qualified plan, as well as those participating in qualified plans, have the option of IRAs, which are truly the most formidable form of portable pension. Perhaps the more important task is the education of the public at large as to how to translate the sum of the defined contribution plus the investment earnings into an ultimate retirement income. This certainly does not require legislative mandate, but it is an education process that could be carried out on a variety of levels.

The proposed legislation appears to favor defined benefit plans versus defined contribution plans. This mystifies me inasmuch as, based on my experience with employees, the defined benefit plan is often perceived as more valuable. If an employer has both a defined benefit plan and a defined contribution plan usually the defined contribution plan will be favored by employees even if it is less costly. If employees have a choice between a defined benefit plan and a defined contribution plan, the defined contribution plan will usually be chosen over the defined benefit plan even if the defined benefit plan is more costly to the employer. The situation of choice frequently occurs at the time an individual is choosing between job offers or transfers within a company.

I would urge continuing parity in the treatment of plans, with two important exceptions. First, that there not be unreasonable restrictions on defined contribution distributions. The effect of income taxes on distributions is in itself a sufficient restriction. I would also urge temperance on limitations on in-service withdrawals. Too many negative provisions could reduce the level of participation in these plans. The current so-called hardship limitations on withdrawals in 401(k) plans seem to be quite adequate. The current rules that penalize employees who make withdrawals from after-tax savings also appear to be adequate. However, if further restrictions are enacted, it should be on prospective contributions only, on account balances up to the date of enactment, or some period after the date of enactment. In order to allow for an orderly transition they should be treated under the rules in effect at the time the contributions were made.

There appears to be a vast array of issues to be dealt with in the pension reform arena. I would welcome the opportunity to participate with you in a continued development of policy that can respond to existing and future needs.

Statement of James P. Klein of Towers, Perrin, Forster & Crosby, Inc.

My name is James P. Klein and I am making a statement on behalf of Towers, Perrin, Forster & Crosby, Inc.

We were pleased to see that the Retirement Income Policy Act was structured in the context of a national policy that seeks to achieve broad social objectives. For too long, our federal pension laws have been driven by tax and revenue policies which have often been counter-productive in terms of extending coverage and meeting broad social objectives.

In general, we support the bill and most of its objectives. More specifically, we support the objectives of: distinguishing between retirement and "non-retirement" plans; recognizing that the goals and objectives of these two types of plans are different and that both types deserve legislative support; requiring meaningful retirement benefits before non-retirement benefits can be provided; broadening coverage requirements; simplifying integration rules; and eliminating the combined Section 415 limit.

The following are specific comments and suggestions as to the provisions of the bill, as now drafted. These suggestions are made with a view toward clarification and to minimize the need for regulatory interpretation.

Definition of Retirement Plan

In regard to the definition of retirement plan, Sections 102 and 202 define a retirement plan as one which provides for distribution of the accrued benefit only upon the participant's attainment of age 59½, disability, or death except in the case of a benefit paid in "retirement income form." A benefit is in "retirement income form" if it is a level distribution over the life expectancy of the participant. The bill properly allows adjustments for social security supplements and cost of living adjustments. However, a literal reading of this language would forbid distribution in the form of a life annuity; a life annuity is not the same as a level distribution over a life expectancy.

Moreover, the description of retirement income does not recognize the need for a joint and survivor life annuity, particularly where the participant has a spouse. Also, the provision allowing distributions from a retirement plan after age 59½ does not seem to require that the participant have severed employment. Was it intended to permit in-service distributions from a retirement plan after age 59½?

Furthermore, the use of age 59½ as a minimum age for distributions -- including lump sum distributions -- continues a concept in current law. However, it is a concept which ignores the fact that almost all existing retirement plans permit retirement beginning as early as age 55. We recommend the use of age 55 in this regard since it recognizes actual practice and the fact that many individuals do, in fact, retire earlier than age 59½. There is no acceptable rationale for using age 59½. Finally, the definition of retirement plan could also be interpreted to require distributions to be paid in full not later than the later of the end of the taxable year in which the employee attains age 70½ or retires. We believe it would be clearer to provide for the commencement of distribution not later than these times.

Coverage Requirements

In regard to coverage requirements, while we support the objective of extending coverage, the requirement of covering 100% of the relevant work force of the employer seems unduly restrictive. We favor the use of a lower percentage and/or a redefinition of the "relevant work force" -- for example, to permit the exclusion of part-time and seasonal employees who, under current law, must be included if they work more than 1,000 hours per year but less than a full-time basis. The 100% standard, as drafted, would disqualify many current plans, and offers no room to deal with the many different situations faced by a "controlled group" of employers.

The 80% test for allowable subdivisions offers limited relief. However, in our judgment, if there are allowable subdivisions, each should have to meet the coverage requirements independently, without regard in an overall coverage percentage for the entire group.

Definition of Compensation

In connection with the definition of compensation, under Sections 104 and 204, relating to the minimum level of benefits, and under Sections 131 and 231, dealing with revised integration rules, compensation is defined "within the meaning of Section 415."

The use of Section 415 for these purposes raises several questions: Is this reference only for purposes of determining the elements of compensation to be included? If so, this may be inappropriate since the Section 415 definition is very broad and includes items not normally part of pensionable earnings -- *e.g.*, imputed income for group life insurance. Does this reference also encompass the three-year final average pay definition in Section 415? We expect that it does not; if so, this should be clarified. Could this reference to Section 415 also be construed such that compensation is to be determined on a limitation rather than a plan year basis? We do not think this was intended and, in any event, this should be clarified.

Overall, we suggest that the bill define compensation in terms of the elements to be included and the time period involved. The references to Section 415 are confusing and raise questions of interpretation.

Meaningful Retirement Benefit

Sections 104 and 204 set forth the minimum retirement benefit that must be provided before a non-retirement plan can be established. It is not clear whether the defined benefit minimum is based on career or final average pay. We believe the intent was to use career pay, but the provision could be interpreted to require a final pay base. This should be clarified.

Cash or Deferred Plans

In connection with cash or deferred plans, Section 111 adds a new section 214 to Title 1 of ERISA, which, as drafted, states that a retirement plan can include a cash or deferred option only if it is a qualified cash or deferred arrangement. The section does not state anything with respect to a pension plan which is not a retirement plan. Thus, the restriction applies only to retirement plans. If it is the goal of the bill to restrict cash or deferred arrangements solely to retirement plans, which the tax sections accomplish, then we believe that the language of the revised Section 214 should state that a pension plan may include a cash or deferred arrangement only if it is a retirement plan (or pre-ERISA money purchase plan).

Changes to Integration Rules

Sections 131 and 231 of the bill as drafted establish two simple integration rules which we strongly support. The first, dealing with money purchase and defined benefit excess plans, states that contributions for an employee can be no more than twice as high above the integration level as below. The second rule, dealing with offset plans, states that offset can be no more than 50% of the otherwise payable benefit. Section 131(c) and 231(c) make the regulations in effect prior to RIPA continue in effect "to the extent not otherwise required." The meaning of this is unclear, but it could be interpreted to require that these two tests would be in addition to the current regulations under Section 401(a)(5) of the Code. This would be undesirable. We believe that the intent was that the RIPA tests be applied in lieu of current tests; the legislative language should clarify this objective.

In connection with integration, it should be made clear, in the case of excess plans, that compensation may be either on a career pay or final average pay basis (not less than three years). It should also be made clear that compensation is not limited to twice the integration break point for plans with a formula that doubles above the integration point.

We also recommend that offset plans be permitted to use career pay or a final average pay of at least three years. Moreover, the provision that no adjustments are to be made for ancillary benefits should be expanded to make it clear that adjustments are not to be made for items such as subsidized early retirement, disability income, and both pre and post-retirement death benefits. Also, we see no rationale for limiting integration capability to five times the social security wage base. Finally, there is an apparent numbering error in Section 131. Sections 131(1) and 131(2) should be 131(a) and 131(b) for consistency.

Distributions

"Retirement plan" distributions must be in a "retirement income form" if they are made prior to age 59½. In furtherance of this, Section 251 seeks to amend Section 411(a)(11), which allows plans to distribute accrued benefits below $3,500 directly to a participant and above that amount to a participant only with his consent. The amendment apparently attempts to restrict distributions to a direct transfer to an IRA. Unfortunately, the method by which the draft elects to do this is by adding a clause to the end of Section 411(a)(11)(A). After this clause is added, the language literally states that the benefits should not be treated as nonforfeitable if the plan provides that the present value could be distributed without the consent of the participant to an IRA. Thus, RIPA inadvertently repeals the current prohibition of making distributions in excess of $3,500 to an employee without his consent. We question whether this result was intended.

Changes to Section 415 Limits

We support the simplification inherent in tying the dollar limits of Section 415 to the social security wage base. We believe the removal of the rules limiting benefits for combined defined benefit and defined contribution plans is a proper goal. We note that the bill does remove them entirely, except for participants in a top-heavy plan. In light of the rules applicable to top-heavy plans, and in light of the reduced limits already provided in Section 415, we question whether it is necessary to keep these cumbersome and complicated rules for even top-heavy plans.

While we generally agree with the concept of indexing the dollar limits in Section 415 automatically to the social security wage base, we do not believe it appropriate to lower the limits currently in effect. This causes undue complexity and hardship. We would recommend, for example, that the $90,000 limit be retained as a floor. The Section 415 limit would then be the greater of $90,000 or two times the social security wage base. A similar approach could be used for defined contribution plans.

The proposed limit for salary reduction amounts is 25% of the social security wage base. However, the language of Section 214 could be interpreted to apply this limit to the entire employer contribution and not just to the amount attributable to salary reduction.

Simplified Employee Pensions

In the summary of RIPA provisions, it is stated that simplified employee pensions are only available to employers of fewer than 25 employees. The bill is unclear on this point. Section 252 simply adds an additional requirement of qualification for a SEP, in Section 408(k)(6), which applies to employers, with 25 or fewer employees. The language of this additional requirement does not accomplish the goal of authorizing salary reduction arrangements. In proposed 408(k)(6)(A)(i), an employee may elect to have the employer make payments as contributions to the SEP or to take them in cash. In 408(k)(6)(A)(ii) it is stated that an election described in clause (i) must be in effect with respect to not less than 50% of the employees of the employer. Unfortunately, this clause does not state in which direction the election should run -- either to take cash or to take a deferred benefit. We believe the intent is to require 50% of the employees to elect to take the deferred benefit. This language should be clarified.

In addition, 408(k)(6)(A)(iii) requires a deferral percentage test for plans covering owner employees. We question whether it is necessary to include this test. In view of the general intent of the law to treat self-employed individuals and small corporations similarly, we do not think the distinction is necessary.

The current limitation on compensation which may be taken into account for a SEP is changed by RIPA from $200,00 to five times the social security wage base. Section 254, through an apparent error, refers to Section 408(k)(3)(C) as it existed prior to TEFRA Section 238(d)(4)(C), which was effective January 1, 1984. Thus, the amendment to change a $100,000 limit in that former section to 2½ times the wage base is no longer needed. This section should be rewritten to conform to current law.

We also question the necessity of requiring the bank trustee of each IRA included in the SEP to undertake the full fiduciary duties of an ERISA trustee. (See RIPA Section 252(b)). We believe that this requirement is not necessary and should not be included in the bill.

Effective Dates

In regard to effective dates, in general, RIPA would allow plans until December 31, 1990 to incorporate the provisions of the act by amendment. However, the effective date is also set as the earlier of the effective date of a post-enactment amendment or December 31, 1990. Thus, if a plan needs to amend for a reason unrelated to RIPA and before 1990, all of RIPA would become effective. This could happen, for example, if all plans were required to be changed before 1990 by reason of some regulation or ruling made under current law.

Furthermore, the effective date for a collectively-bargained plan would be even earlier, since RIPA sets the effective date for such plans as the earliest of the expiration date of the last relevant collective bargaining agreement, the effective date of a post-enactment amendment, or December 31, 1990.

We believe that a more consistent effective date should be used. The provisions of RIPA are broad reaching and should become effective for all plans at the same time.

Conclusion

Once again, we would like to express our support for the general concepts embodied in RIPA, and we hope that you find these comments to be helpful. We would also like to offer our service to assist you in any way possible.

HEARINGS BEFORE THE SENATE FINANCE COMMITTEE, SUBCOMMITTEE ON SAVINGS, PENSION AND INVESTMENT POLICY

RETIREMENT INCOME POLICY BILL

S. 1784

STATEMENT OF TEACHERS INSURANCE AND ANNUITY ASSOCIATION - COLLEGE RETIREMENT EQUITIES FUND (TIAA-CREF)

TIAA-CREF is a nationwide pension system which provides portable pension benefits to the educational community. TIAA-CREF retirement plans are in operation at about 87% of private colleges and universities, and those institutions employ about 89% of faculty in all private colleges and universities. TIAA-CREF plans are also in effect in 63% of publicly supported colleges and universities, which coincidentally employ 63% of faculty in all public colleges and universities. These institutions generally fund their pension plans under Section 403(b) of the Internal Revenue Code. Except for certain governmental and church institutions, these plans are subject to Title I of ERISA. However, the nondiscrimination rules are not currently included in Title I and thus apply only to pension and profit sharing plans qualified under Section 401 of the Internal Revenue Code.

Section 131 of the Retirement Income Policy Bill would add a new Section 215 to Title I of ERISA which states in part that:

contributions and benefits provided under a pension plan may not discriminate in favor of employees who are ---

(1) officers,
(2) shareholders, or
(3) highly compensated.

Since Section 403(b) plans of private colleges and universities are subject to Title I, these plans would become subject to nondiscrimination rules. It is unclear how nondiscrimination would be determined under this provision since no further elaboration is contained in Title I.

The proposal is presumably based upon a general policy that retirement benefits should be available to more highly compensated and supervisory employees only if benefits are provided to lower-paid employees on a substantially equivalent basis. We do not question this general policy. However, based upon the information available, we do not believe that a significant problem of discrimination against lower-paid employees exists under the retirement programs of U.S. colleges and universities. We therefore urge that college budgets not be heavily and unnecessarily burdened with inside administrative costs and outside legal, actuarial and accounting expenses in order to restructure retirement plans and to prove comparability on a continuing basis.

Application of the existing tax comparability tests to the multiple retirement structures that exist at many educational institutions could, we think, simply result in saddling colleges with large unproductive administrative costs. See Revenue Ruling 81-202, 1981-2 C.B. 93, attached, which illustrates the complications of showing comparability among different types of plans. Unless it can be shown that the application of such comparability rules is truly needed to protect lower-paid employees, pension objectives would be much better advanced by permitting such funds to be expended directly for retirement benefits rather than consumed in plan administration.

The complex retirement plan structures of colleges and universities have developed over the years in response to their unique needs. The market for faculty members involves nationwide locations, both in recruiting and departures. Thus, the portability obtainable with a defined contribution plan is of major importance in acquiring and retaining faculty members. In contrast, both the recruiting and departures of clerical and service personnel primarily involve local employment markets, with a practical need that retirement arrangements meet local standards which generally emphasize defined benefit plans. Also of major importance for all colleges, and especially for smaller institutions, is obtaining educational diversification from visiting and transferred professors, which often requires a college as a practical matter to match the retirement program of the existing employer and to waive any normal service requirements for eligibility.

Although the present form of the bill would not apply to state institutions, the Committee should not extend the nondiscrimination requirement to the Internal Revenue Code provisions (Title II of ERISA) without considering the special problems of such institutions. Section 1113 of H.R. 3838, which passed the House in December would extend the tax nondiscrimination rules to nonelective Section 403(b) retirement annuities, and therefore would apply nondiscrimination requirements to Section 403(b) plans of government institutions. State laws applicable to state universities and colleges typically require clerical and service employees to be covered in a general state retirement system, which in many instances is separate from the state teachers' retirement system; generally, both of such state systems are defined benefit plans. However, in response to the difficulty in attracting and retaining faculty personnel under non-portable state systems, seventeen states have provided alternative optional defined contribution retirement plans for faculty employees, covering 347 state colleges and universities. As a result, the pension structures of many state institutions are quite complex and offer particular difficulty in showing comparability on a continuing basis.

If some protection for lower-paid employees of education organizations is shown to be needed (contrary to our belief), a study could explicitly focus on whether the need could be specifically identified and met by a targeted provision involving much lower continuing overhead costs for the institutions than would be required by imposing existing comparability standards. In this connection, we note that the opportunity for colleges to provide discriminatory benefits to higher compensated employees under Section 403(b) is already severely restricted by the limited compensation and compressed salary scale available at most educational institutions, and by the fact that Section 403(b) plans are already subject to the limitations of both Section 415 and Section 403(b)(2).

If, notwithstanding the foregoing, the Congress concludes that it is necessary to act on the basis of its available information, we urge that the Congress seek means to assure compliance with its policy goals that would involve substantially lower compliance costs for the colleges and the Department of Labor and the Internal Revenue Service than would result from the broad application of existing tax comparability tests.

For example, in lieu of individual comparability testing, the statute could assure adequate coverage of lower-paid employees by imposing minimum coverage and benefit requirements as a condition to qualification of a Section 403(b) plan. This could be accomplished by providing that benefits can be provided under Section 403(b) to higher-paid employees only in circumstances where lower-paid employees are covered by the minimum retirement benefits stated in the Bill for determining eligibility for nonretirement plans.

If nondiscrimination requirements are to be imposed generally on basic college retirement plans, some of the special problems of academic institutions that should be considered in any such proposed legislation (and that should be reviewed as a part of any proposed study) are the following:

(a) Colleges generally do not have the resources to make open-ended pension commitments for a pension that is based upon final pay. Prudence requires that most college pension commitments be funded on a current basis.

(b) The interchange of faculty members, including arrangements for visiting professors, is of major importance in enlarging an institution's educational horizon, particularly for smaller colleges. Pension portability is best accomplished with a defined contribution plan. In contrast, the clerical and service staffs of most colleges come from local sources; frequent transfers of these employees are not required to enrich the institution's educational program. Arrangements for visiting and transferred faculty members raise special problems of waiving normal service eligibility requirements and providing adequate defined contribution levels for older employees.

(c) Under typical college programs of defined benefit plans for the service staff and defined contribution plans for faculty members, the apparent comparability of level rates of contributions under defined contribution plans may in fact severely discriminate against older employees as compared with level accrual of benefits under defined benefit plans. That is, the cost of an annuity benefit accrual at a specified rate increases greatly with advancing age; correspondingly, the annuity benefit provided by a level rate of contribution decreases greatly with advancing age.

(d) Under the Internal Revenue Service's existing rules, the determination of comparability of contributions under a defined contribution plan, if made at different rates based upon the participant's age, or if compared with defined benefit plans, requires redetermination of the value of the existing accumulation each time a comparability test is made. Such continuing redeterminations can result in extensive ongoing actuarial and administrative costs. Much of this complexity and expense could be eliminated without prejudice to the general policy of nondiscrimination if comparability under defined contribution plans were permitted to be determined based on reasonable actuarial assumptions made as at the time contributions are made, without regard to subsequent actual investment experience.

(e) In response to different needs, many states have established a complex retirement program for their educational institutions involving separate types of state arrangements for teachers and for service staffs, and also involving other faculty plans providing portability that are an alternative to such state retirement system. The procedures for adapting these structures to any changes in the labor or tax law requirements are unclear.

(f) The multiple types of plans at many educational institutions often have varying features (based on practices in the different employee markets, historical development, provisions of state law, etc.) that do not seem significant in assuring lower-paid employees a generally comparable level of benefits to those provided for higher-paid employees, but that present substantial difficulties in valuation for comparability purposes. We suggest that the application of a general nondiscrimination policy to educational organizations might appropriately disregard variations among plans with respect to such features as the following:

(i) variations in vesting provisions within the minimum standards provided by Internal Revenue Code Section 411;

(ii) variations in the rate of required contributions by employees, provided that the rate of contributions by the employer and the coverage is not discriminatory; and

(iii) variations in optional forms of payment, provided that the options available under any particular plan are all of equivalent value.

(g) The level of retirement benefits provided by a defined contribution plan often seems inadequate in dealing with the special problems for colleges and universities in adjusting their faculty personnel requirements by proposing selective early retirement for particular employees. At a minimum, contributions at termination of employment that do not exceed the limitations provided by Internal Revenue Code Section 415(c)(4)(A) should not be regarded as discriminatory.

(h) An educational institution should be permitted to exclude from plan coverage any employee who is enrolled in a program leading to the grant of a degree by the institution.

IRA within 60 days after receipt under the tax-free rollover provisions of section 402(a)(5) of the Code. While a distribution of property other than money may be rolled over into an IRA, a contribution to an IRA may not include the transfer of a retirement income, endowment or other life insurance contract because section 408(a)(3) specifically precludes investment of IRA funds in life insurance contracts.

Accordingly the employee in this case may transfer into an IRA the cash portion of the qualifying rollover distribution, after deducting employee contributions, and exclude those amounts from gross income in the year received. However, the employee may not transfer the life insurance contract into an IRA. Therefore, the value of the life insurance contract, except for amounts which are considered as having been contributed by the employee, is taxable in accordance with the rules of section 402 of the Code.

However, notwithstanding the above conclusion, a rollover of the life insurance contract may be effected if it is made to an eligible retirement plan as defined in section 402(a)(5)(D)(iv), such as a trust qualified under section 401, that does not otherwise preclude investments in life insurance contracts.

This ruling does not deal with the employee's option to surrender or sell the insurance contract and rollover the proceeds into an IRA. For those rules see section 402(a)(6)(D) of the Code.

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26 CFR 1.408-3 Individual retirement annuities

Whether the contracts described in four fact situations are annuity contracts described in section 403(a) or (b) or section 408(b) of the Code. See Rev. Rul. 81-255, page 12.

Subpart B.—Special Rules

Section 410.—Minimum Participation Standards

26 CFR 1.410(b)-1 Minimum coverage requirements
(Also Section 401, 1.401-4)

Qualification; discrimination; comparing benefits or contributions in separate plans. Guidelines are provided for determining whether several plans, considered as a single plan, provide contributions and benefits that discriminate in favor of employees who are officers, shareholders, or highly compensated. Rev. Rul. 70-580 superseded.

Rev. Rul. 81-202

SECTION 1. PURPOSE

This revenue ruling provides guidelines for determining whether several different retirement plans, considered as a unit, provide contributions or benefits that discriminate in favor of employees who are officers, shareholders, or highly compensated (the prohibited group). These guidelines do not constitute an exclusive list of the methods that may be used to demonstrate that two plans, taken as a unit, do not discriminate in favor of the prohibited group. This revenue ruling also supersedes Rev. Rul. 70-580, 1970-2 C.B. 90.

SEC. 2. BACKGROUND

.01 Section 410(b) of the Internal Revenue Code requires that, in order to satisfy the requirements of section 401(a) of the Code, a retirement plan must cover either a certain percentage of employees or a classification of employees that does not discriminate in favor of the prohibited group.

.02 Section 1.410(b)-1(d)(3)(i) of the Income Tax Regulations allows an employer to designate two or more plans as a single plan for purposes of satisfying the requirements of section 410(b) of the Code. (Section 1.410(b)-1(d)(3)(ii) of the regulations prohibits this designation in certain cases involving TRASOPs and plans subject to section 401(a)(17)). However, if several plans are so designated as a unit, the plans considered as a unit must also satisfy the nondiscrimination requirements of section 401(a)(4).

.03 Section 401(a)(4) of the Code requires that, in order to satisfy the requirements of section 401(a), either the contributions or the benefits under a retirement plan must not discriminate in favor of the prohibited group.

.04 Section 401(a)(5) of the Code provides that a retirement plan shall not be considered discriminatory, within the meaning of sections 401(a)(4) and 410(b), merely because the contributions or benefits of employees under the plan differ because of any retirement benefits created under State or Federal law. An example of such retirement benefits is the old age, survivors, and disability insurance benefits under the Social Security Act (social security benefits). Section 1.401-3(e) of the regulations and Rev. Rul. 71-446, 1971-2 C.B. 187 provide rules for measuring the value of employer-provided social security benefits.

.05 Section 401(a)(5) of the Code also provides that several plans of an employer shall not be considered discriminatory, within the meaning of section 401(a)(4), merely because employees' rights to benefits under the separate plans do not become nonforfeitable at the same rate. Rev. Ruls. 74-165, 1974-1 C.B. 96 and 74-166, 1974-1 C.B. 97 provide rules for measuring the value of differing vesting schedules.

SEC. 3. GENERAL RULE

.01 *General Rule*—Several plans, considered as a unit, will satisfy the nondiscrimination test of section 401(a)(4) of the Code as to the amount of benefits or contributions, if either the Normalized Employer-Provided Benefits or both the Actual Employer Contributions and the Adjusted Employer Contributions do not constitute a greater percentage of non-deferred compensation for prohibited group employees than for rank and file employees. The choice of either testing Normalized Employer-Provided Benefits or both Actual and Adjusted Employer Contributions may be made by the taxpayer independent of whether the plans being considered are defined benefit plans or defined contribution plans. In testing for discrimination, the normalized employer-provided social security benefits or actual and adjusted employer contributions to social security may be taken into account. (See section 6.) In testing for discrimination, reasonable groupings of participants by compensation ranges may be made. However, pursuant to section 401(a)(10) of the Code, a plan providing benefits for an owner-employee may not provide contributions or benefits for employees that are less favorable than contributions or benefits for owner-employees.

.02 *Normalized Employer-Provided Benefits defined*—For purposes of this revenue ruling, Normalized Employer-Provided Benefits are the flat benefits or unit benefits computed under section 4, normalized in accordance with section 5 to reflect the value of an annuity for the life of the participant commencing at age 65 with no death benefits and no other ancillary benefits and to reflect a difference in vesting provisions among the plans being considered.

.03 *Actual and Adjusted Employer Contributions defined*—

(1) Defined contribution plans—In the case of a defined contribution plan, the Actual Employer Contributions are the employer contributions allocated to the account of a participant (not including forfeitures, even if used to reduce employer contributions) and the Adjusted Employer Contributions are the sum of the employer contributions and forfeitures allocated to the account of the participant.

(2) Defined benefit plans—In the case of a defined benefit plan the Actual and Adjusted Employer Contributions are identical. Such contributions are the annual level dollar contributions from the date of initial participation in the plan to the latest of 65, current age, or the normal retirement age to fund the normalized flat benefit described in section 5.02. These contributions must be determined using solely reasonable interest and mortality assumptions.

SEC. 4. LEVEL OF EMPLOYER BENEFITS

.01 *Flat benefit basis*—

(1) Defined benefit plans—In the case of a defined benefit plan the flat benefit used for testing discrimination is the employer-provided portion of the participant's most valuable projected benefit. The participant's most valuable projected benefit is determined by projecting the accrued benefit to which the participant would be entitled at each possible retirement age based on the assumption that he or she continued to earn annually until such age the same rate of compensation as in the current year. This computation is made without regard to any benefit attributable to voluntary employee contributions. See section 411(d)(5) of the Code. These projected benefits are expressed as the actuarial equivalent amount of plan benefit commencing at age 65, and the most valuable projected benefit is selected. The employer-provided portion of the participant's most valuable projected benefit is the total benefit reduced by the projected benefit at age 65 attributable to mandatory employee contributions that would be made to the date of the most valuable projected benefit.

(2) Defined contribution plans—In the case of a defined contribution plan that provides a pre-retirement death benefit not less than the account balance, the participant's normalized flat benefit is determined as the amount purchasable as a life annuity commencing at age 65, by the accumulation, using a reasonable mortality and interest rate, of both (a) the participant's account balance in the year that discrimination is being tested, and (b) all reasonably estimated future Adjusted Employer Contributions for the participant. In the case of a defined contribution plan that provides no pre-retirement death benefit at any time other than the minimum required benefit under section 401(a)(11)(C) (relating to joint and survivor annuities), the participant's normalized flat benefit is determined as the amount purchasable as a life annuity commencing at age 65 by the accumulation, using a reasonable interest rate only, of both (a) the participant's account balance in the year that discrimination is being tested, and (b) all reasonably estimated future Adjusted Employer Contributions for the participant. In the case of a money purchase plan, future Adjusted Employer Contributions shall be determined as the amount specified in the plan. Thus, for example, in a plan that provides for contributions of X% of compensation reduced by forfeitures, future Adjusted Employer Contributions are X% per year.

02 *Unit benefit basis* For either a defined benefit or defined contribution plan, the unit benefit may be determined by dividing the flat benefit computed as described in subsection .01 by the years of service the participant would have at the age at which the flat benefit was determined. Service must be determined on a reasonable and consistent basis.

SEC. 5. NORMALIZING BENEFITS

.01 *General Rule*—In the case of a defined benefit plan providing ancillary benefits, the flat benefit described in section 4.01(1) must be normalized by multiplying such flat benefit by the factors described in subsections .02, .03, .04, and .05 in succession.

.02 *Form of annuity*—If the plan provides benefits in a form other than as a single life annuity, the adjustment factor is the ratio of the present value of benefits under such form to the present value of benefits under a life annuity. The reciprocals of the factors found in section 9 of Rev. Rul. 71-446 may be used for this purpose.

.03 *Pre-retirement death benefit*—If the plan provides for pre-retirement death benefits, the adjustment factor is the ratio of the present value of death benefits and retirement benefits to the present value of retirement benefits. The reciprocals of the factors used in section 8 of Rev. Rul. 71-446 may be used for this purpose.

.04 *Disability benefit*—

(1) If the plan provides a qualified disability benefit (as defined in section 411(a)(9) of the Code), commencing at disability and payable for life, or until recovery from disability before normal retirement age, and such benefit is payable only for the period of time when the participant is eligible for and receives disability benefits under the Social Security Act, the disability adjustment factor is 1.11.

(2) If the plan provides any other form of disability benefit, such benefit shall be considered under section 4.01 as a retirement benefit.

.05 *Vesting*—If the plans being

compared provide for different rates of vesting, the level of benefits may require adjustment by a vesting adjustment factor. Section [illegible] of the Code provides for adjustments in such a situation. However, until regulations are adopted under this section, see Rev. Rul. 74-166.

SEC. 6. IMPUTING SOCIAL SECURITY BENEFITS OR CONTRIBUTIONS

.01 *In general*—Except as provided in subsections .04 and .05, if the plans of an employer, when considered as a unit, discriminate in favor of the prohibited group, this discrimination may be eliminated by considering employer-provided social security benefits as Normalized Employer-Provided Benefits or as both Actual and Adjusted Employer Contributions. This section provides rules for measuring the value of the employer-provided social security benefits or contributions. Subsections .02 and .03 provide rules for measuring the value of social security in testing whether plans discriminate in favor of a participant who is not an owner-employee. Subsection .04 provides rules for measuring the value of social security in testing whether plans discriminate in favor of an owner-employee. If social security benefits or contributions are imputed, they must be imputed for all individuals in the same manner.

.02 *Imputing social security benefits*—

(1) Flat benefits—In the case of a plan testing for discimination on a flat benefit basis, employer-provided social security benefits may be determined under either (A) or (B) below.

(A) The imputed social security benefits equal 37½ percent of a participant's highest five-year average compensation, to the extent such compensation does not exceed the participant's covered compensation. For a participant with less than 15 years of service at expected retirement age, this amount should be reduced to 2½ percent per year of service. Covered compensation in any plan year will be determined in accordance with the rules set forth in section 3.02 of Rev. Rul. 71-446, as clarified by Rev. Rul. 78-92, 1978-1 C.B. 118.

(B) The imputed social security benefits equal 83⅓ percent of the participant's primary insurance amount, determined using the same assumptions that are used to compute the flat benefit under section 4.01.

(2) Unit benefits—In the case of a plan testing for discrimination on a unit benefit basis, employer-provided social security benefits may be determined under either (A) or (B) below.

(A) The imputed social security benefits equal 1.4 percent of compensation in any year to the extent such compensation does not exceed the taxable wage base for the calendar year within which the plan year ends.

(B) The imputed social security benefits equal the amount determined under paragraph (1) divided by the participant's projected years of service as used in section 4.02.

.03 *Imputing social security contributions*—Both actual and adjusted employer contributions to social security for a plan year are deemed to be 7% of the participant's compensation in that year to the extent that such compensation does not exceed the taxable wage base for the calendar year within which the plan year ends.

.04 *Discrimination in favor of an owner-employee*—

For purposes of testing whether several plans discriminate in favor of an owner-employee,

(1) if such owner-employee participates in a defined benefit plan, social security benefits may not be taken into account, and

(2) if such owner-employee participates in a defined contribution plan, social security benefits may only be taken into account if the requirements of section 401(d)(6) are satisfied.

.05 *Multiple integration*—This subsection only applies in the case where there is some participant covered in one or more of the combination of plans being tested for discrimination who is covered under another plan (not in the combination) maintained by the employer in which social security must be imputed for that plan to be nondiscriminatory (i.e., an integrated plan). In this case, the amount of social security benefits or contributions imputed under subsections .02 and .03 is multiplied for each participant by the multiple integration factor that is lowest for any participant. The multiple integration factor is equal to the excess, if any, of the number 1 over the sum of the integration utilization factors for all other plans in which this individual participates. The integration utilization factor is the ratio of (a) the lowest amount of social security benefits or contributions needed to be imputed for that plan to be nondiscriminatory, to (b) the maximum amount that may be imputed under this section.

SEC. 7. REASONABLE INTEREST RATES

.01 For purposes of this revenue ruling, all computations must be based on reasonable actuarial assumptions. Although the assumptions used for every purpose need not be identical, they must not be applied in an inconsistent manner so as to distort the results.

.02 The reasonableness of the interest rate is determined under the facts and circumstances. For purposes of this revenue ruling, an interest rate not less than 5 percent nor more than 6 percent will automatically be considered reasonable.

SEC. 8. SCOPE OF REVENUE RULING

This revenue ruling considers only whether the amount of benefits or contributions are discriminatory in ongoing plans. However, other aspects of discrimination could nonetheless exist. For example, in the case of two plans each providing full vesting after 10 years service, more rapid vesting may be needed to satisfy the requirements of section 411(d)(1) of the Code. See Rev. Proc. 76-11, 1976-1 C.B. 550. The adjustment described in section 5.05 adjusts for a difference in vesting schedules but does not consider the minimum vesting necessary to preclude discrimination.

SEC. 9. EXAMPLE

.01 *Facts*—Employer M maintains a defined benefit and a defined contribution pension plan in 1981. Neither plan permits employee contributions.

(1) The defined benefit plan covers all the rank and file employees of M, and provides for a benefit accrual each year of 2 percent of that year's compensation. This benefit is provided in the form of a life annuity paid monthly starting at age 65. The plan also provides an insured death benefit prior to retirement of 100 times the anticipated monthly annuity. The plan provides full and immediate vesting but does not provide an early retirement benefit.

(2) The defined contribution plan covers the two shareholders of M and provides for contributions each year of 20 percent of that year's compensation. The plan provides for full and immediate vesting and a preretirement death benefit of the participant's account balance. Considered alone, the defined contribution plan does not satisfy the coverage requirements of section 410(b) of the Code and must be considered in combination with the defined benefit plan to satisfy the coverage and nondiscriminatory requirements.

(3) The participants in the plans and other information is shown below:

Defined Contribution Plan

Participant	*Current Age*	*Prior Service*	*Current Compensation*	*Account Balance Beginning of Year*
A	55	10	$100.000	$280.000
B	50	6	90.000	120.000

Defined Benefit Plan

Participant	*Current Age*	*Prior Service*	*Current Compensation*	*Accrued Benefit Beginning of Year*
C	45	10	$12.000	$2.300
D	35	0	10.000	0

.02 *Analysis of comparability*—In accordance with section 3.01, the plans may be tested for discrimination by comparing either the Normalized Employer-Provided Benefits or both the Actual and Adjusted Employer Contributions. The analysis below first considers whether the Normalized Employer-Provided Benefits are nondiscriminatory. In accordance with section 3.02, the Normalized Employer-Provided Benefits may be compared as either flats benefits or unit benefits.

.03 *Flat benefit basis*—

(1) Defined contribution plan—In order to compare the Normalized Employer-Provided Benefits on a flat benefit basis, one must determine the normalized benefit for the two employees in the defined contribution plan. Because the defined contribution plan provides a pre-retirement death benefit of not less than the account balance, in accordance with section 4.01(2) the normalized benefit is determined by projecting both the account balance and future assumed Adjusted Employer Contributions to age 65 and determining the single life annuity which is actuarially equivalent to this projected account balance. In this example, the UP 1984 Mortality Table and 5 percent interest are used for this purpose.

The Normalized Employer-Provided Benefit on a flat benefit basis is computed as follows:

Table 1

	A	*B*
(1) 1981 Age (x)	55	50
(2) Account Balance Beginning of 1981	$280.000	$120.000
(3) Account Projection Factor*	.1869	.2470
(4) (2) × (3)	52.332	29.640
(5) 1981 Compensation	100.000	90.000
(6) Assumed Adjusted Employer Contributions [20% of (5)]	20.000	18.000
(7) Contribution Projection Factor**	1.4461	2.5559
(8) (6) × (7)	28.922	46.006
(9) Normalized Employer-Provided Benefit [(4) + (8)]	81.254	75.646

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* Actuarial factor to determine amount of life annuity payments each year commencing at age 65 for each $1 of account balance at age x. Expressed in standard actuarial notation, this factor is computed as

$$D_x \div N_{65}^{(12)}$$

** Actuarial factor to determine amount of life annuity payments to be paid each year commencing at age 65 for each $1 of annual contribution from age x to age 65. Expressed in standard actuarial notation, this factor is computed as

$$(N_x - N_{65}) \div N_{65}^{(12)}$$

(2) Defined benefit plan—Because the defined benefit plan provides for no early retirement benefits, the flat benefit determined under section 4.01(1) is the sum of 2% of current compensation times the number of years from the attained age to age 65 plus the current accrued benefit. This benefit must then be normalized in accordance with section 5. The plan provides for a pre-retirement death benefit requiring normalization. Although any reasonable actuarial factors may be used for this adjustment, section 5.03 states that the reciprocal $\left(\frac{9}{8}\right)$of the factor shown in section 8 of Rev. Rul. 71-446 (8/9) may be used. For this example, this 9/8 factor is used. The Normalized Employer-Provided Flat Benefit may be computed as follows:

Table 2

	C	D
(1) 1981 Age	45	35
(2) 1981 Compensation	$12,000	$10,000
(3) 1981 Accrued Benefit	2,300	0
(4) No. of Years Until age 65 (65 − (1))	20	30
(5) Future Accruals [2% × (2) × (4)]	4,800	6,000
(6) Most Valuable Projected Benefit [(3) + (5)]	7,100	6,000
(7) Normalization Factor		
(8) Normalized Flat Benefit [(6) × (7)]	7,988	6,750

(3) Comparison – The flat benefits are compared by expressing the normalized flat benefits as a percentage of 1981 compensation.

Table 3

	A	B	C	D
(1) 1981 Compensation	$100,000	$90,000	$12,000	$10,000
(2) Adjusted Normalized Flat Benefit from Tables 1 & 2	81,254	75,646	7,988	6,750
(3) (2) ÷ (1)	81.25%	84.05%	66.57%	67.50%

The percentages are higher for the prohibited group. Therefore, in order to demonstrate that the plan is nondiscriminatory on a flat benefit basis, social security benefits must be imputed using the rules of section 6. Although there are several ways to impute social security benefits, in this example the method described in section 6.02(1)(A) is used. Covered compensation was computed pursuant to section 5 of Rev. Rul. 71-446.

	A	B	C	D
(4) Covered Compensation	$16,260	$18,828	$22,392	$28,260
(5) Lesser of (1) or (4)	16,260	18,828	12,000	10,000
(6) Social Security (37½% of (5))	6,098	7,061	4,500	3,750
(7) Total Benefit [(2) + (6)]	87,352	82,707	12,488	10,500
(8) (7) ÷ (1)	87.35%	91.90%	104.07%	105.00%

Line (8) shows the Normalized Employer-Provided Benefits are nondiscriminatory, and no further computation need be made. However, for illustrative purposes, comparability is also tested on a unit benefit basis and on a contributions basis.

.04 *Unit benefit basis* – In accordance with section 4.02 the unit benefit amount is obtained by dividing the flat benefit amount (on Line (2) of Table 3) by the years of service the participant would have at age 65.

Table 4

	A	B	C	D
(1) Flat Benefit Amount	$81,254	$75,646	$7,988	$6,750
(2) Service at age 65	20	21	30	30
(3) (2) ÷ (1)	4,063	3,602	266	225
(4) Compensation	100,000	90,000	12,000	10,000
(5) (3) ÷ (4)	4.06%	4.00%	2.21%	2.25%

The percentages are higher for the prohibited group. Therefore, in order to demonstrate that the plan is nondiscriminatory on a unit benefit basis, social security benefits may be imputed, as allowed by section 6. Although there are several ways of imputing social security benefits, in this example social security benefits are imputed using the rule described in section 6.02(2)(A). The taxable wage base for 1981 is $29,700.

	A	B	C	D
(6) Lesser of (4) or $29,700	29,700	29,700	12,000	10,000
(7) Social Security (1.4% of (6))	416	416	168	140
(8) Total Unit Benefits ((3) + (7))	4479	4018	434	365
(9) (8) ÷ (4)	4.48%	4.46%	3.62%	3.65%

Even after imputing social security benefits, the benefits under the plans are discriminatory on a unit benefit basis. Nevertheless, because the plan is not discriminatory on the flat benefit basis, the Normalized Employer-Provided Benefits are nondiscriminatory.

.05 *Contributions* –

(1) Defined contribution plan – Section 3.01 provides that contributions will be nondiscriminatory if both the Actual Employer Contributions and the Adjusted Employer Contributions do not constitute a greater percentage of non-deferred compensation for the prohibited group than for the rank and file employees.

Section 3.03(1) defines Actual and Adjusted Employer Contributions. Because there are no forfeitures in the defined contribution plan, the Actual and Adjusted Employer Contributions both equal 20% of compensation, or $20,000 for A and $18,000 for B.

(2) Defined benefit plan—Section 3.03(2) defines the Actual and Adjusted Employer Contributions in the case of a defined benefit plan as the level dollar contribution, required from the date of initial participation to the later of 65, or the normal retirement age, to fund the amount described in section 3.02. The amount described in section 3.02 is the amount contained on line (8) of Table 2. Although any reasonable actuarial assumptions may be used for this computation, the UP 1984 Mortality Table and 5 percent interest are used in this example.

The contributions may be computed as follows:

Table 5

	C	*D*
(1) Flat Benefit (Line (8) of Table 2)	$7,988	$6,750
(2) Age at initial participation (y)	35	35
(3) Level Cost Factor*	.1202	.1202
(4) Adjusted Employer Contribution [(1) × (3)]	960	811
(5) 1981 Compensation	12,000	10,000
(6) (5) ÷ (6)	8%	8%

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* Annual contribution necessary to provide life annuity of $1 per year at age 65 by level dollar contributions from age in (2) to 65. Expressed in standard actuarial notation, this factor is computed as

$$N_{65}^{(12)} \div (N_y - N_{65})$$

(3) Comparison—Expressed as a percentage of 1981 compensation, the contributions are discriminatory. However, as allowed by section 6, social security contributions may be imputed to eliminate this discrimination. Section 6.03 states that social security contributions are deemed to be 7% of compensation up to the taxable wage base. The taxable wage base in 1981 is $29,700.

Table 6

	A	*B*	*C*	*D*
(1) 1981 Compensation	$100,000	$90,000	$12,000	$10,000
(2) Actual and Adjusted Contributions	20,000	18,000	960	811
(3) Lesser of (1) or $29,700	29,700	29,700	12,000	10,000
(4) Social Security Contributions (7% of (3))	2,079	2,079	840	700
(5) Total Contributions [(2) + (4)]	22,079	20,079	1,800	1,511
(6) (5) ÷ (1)	22.08%	22.31%	15.00%	15.11%

Thus, the total contributions are discriminatory. Nevertheless, because the plan is not discriminatory on the basis of benefits, the requirements of section 401(a)(4) of the Code are satisfied.

SEC. 10. EFFECT ON OTHER DOCUMENTS

This revenue ruling supersedes Rev. Rul. 70-580 because the positions stated therein are restated in this ruling.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(a)-1: Minimum vesting standards; general rules.
(Also Section 7805; 301.7805-1.)

Full vesting at normal retirement age. A plan that provides that an employee's right to the normal retirement benefit is nonforfeitable on the normal retirement date, defined as a date which may occur after normal retirement age, will not satisfy the requirements of section 411(a) of the Code.

Rev. Rul. 81-211

Advice has been requested whether the pension plan described below satisfies the requirement of section 411(a) of the Internal Revenue Code, that an employee's right to the normal retirement benefit is nonforfeitable upon attainment of normal retirement age.

A pension plan provides that an employee's right to the normal retirement benefit under the plan is nonforfeitable at the normal retirement date. The normal retirement date is the first day of the calendar month following the date on which the employee attains age 65.

Section 401(a)(7) of the Code provides that a plan shall not be a qualified plan under section 401(a) unless it satisfies the requirements of section 411.

Section 411(a) of the Code requires that an employee's right to the normal retirement benefit under the plan must be nonforfeitable upon the attainment of normal retirement age as defined in section 411(a)(8). Section 411(a)(8) provides that normal retirement age means the earlier of: (a) the